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No. 15193

VOL. 3119

United States  
Court of Appeals  
for the Ninth Circuit

ROBBINS TIRE AND RUBBER COMPANY,  
INCORPORATED, a corporation,

Appellant,

vs.

BAY RUBBER COMPANY, a limited copartnership, EDWIN W. PAULEY, C. J. CAMERON, WESLEY H. DeSELLEM, JOHN B. CONDREY and PACIFIC RUBBER COMPANY, a corporation, Appellees.

Transcript of Record

(In Two Volumes)

VOLUME I.

(Pages 1 to 408, Inclusive)

Appeal from the United States District Court for the  
Northern District of California  
Southern Division

FILED

DEC 19 1956



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Court of Appeals  
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NAMES AND ADDRESSES OF COUNSEL

GEORGE BOUCHARD,  
900 Wilshire Boulevard,  
Los Angeles 17, California,

JAMES C. HERNDON,  
Second National Building,  
Akron, Ohio,

HERBERT W. CLARK,  
Crocker Building,  
San Francisco 4, California,  
Counsel for Appellant.

ORRIS R. HEDGES,  
1054 Wilshire Boulevard,  
Los Angeles 17, California,

HELLER, EHRLMAN, WHITE & McAULIFFE,  
14 Montgomery Street,  
San Francisco 4, California,  
Counsel for Appellees.



In the United States District Court for the Northern District of California, Southern Division

No. 34294—Civil

ROBBINS TIRE AND RUBBER COMPANY INCORPORATED, a corporation, Plaintiff,

vs.

BAY RUBBER COMPANY, a limited copartnership, EDWIN W. PAULEY, C. L. CARMERON, WESLEY H. DeSELLEM, JOHN B. CONDREY, PACIFIC RUBBER COMPANY, a corporation, Defendants.

EXCERPT FROM DOCKET ENTRIES

1954

Dec. 14—Filed complaint—issued 2 summons.

\* \* \* \* \*

1955

Jan. 31—Filed answer of Bay Rubber Company.

Jan. 31—Filed answer of Edwin W. Pauley and C. L. Cameron.

Jan. 31—Filed answer of Pacific Rubber Company.

Jan. 31—Filed answer of Wesley H. DeSellem and John B. Condrey.

\* \* \* \* \*

Aug. 3—Filed deposition of John B. Condrey.

Aug. 3—Filed deposition of Wesley H. DeSellem.

Aug. 12—Filed notice by plaintiff of motion to compel answers in discovery proceedings, Aug. 22, 1956 with supporting affidavit.

\* \* \* \* \*

1955

Aug. 29—Ordered after hearing, motion to compel answers denied without prejudice to renewal at time of pre-trial. (Goodman.)

\* \* \* \* \*

Aug. 30—Filed order denying motion of plaintiff for order compelling answers without prejudice.

\* \* \* \* \*

Sept. 12—Ordered for trial December 14, 1955.  
(Harris.) \* \* \* \* \*

Nov. 22—Filed notice by defts. of taking deposition of Poncet Davis, Nov. 30, 1955.

\* \* \* \* \*

Dec. 2—Filed motion by plaintiff and Poncet Davis for motion to terminate deposition, December 12, 1955, with memo.

Dec. 5—Filed deposition of Poncet Davis.

Dec. 5—Filed deposition of John L. Connolly.

\* \* \* \* \*

Dec. 12—Ordered after hearing, motion for order terminating deposition of Poncet Davis granted. Other motions withdrawn and case continued to Dec. 16, 1955 for trial. (Carter.)

\* \* \* \* \*

Dec. 16—Ordered case assigned to Judge Hamlin for trial this date. (Carter.)

Dec. 16—Court trial. Motion of plaintiff to amend complaint granted. Motion to dismiss as to defendants Edwin Pauley, C. L. Cameron and Pacific Rubber Co. ordered submitted. Motions to dismiss as to Stockholders DeSellem and John Condrey submitted. Evidence and exhibits intro-

Dec. 16, 1955—(Cont.)

duced and further trial continued to Dec. 19, 1955 at 10 a.m. (Hamlin.)

Dec. 19—Further Court trial. Evidence and exhibits introduced. Defendant reserves right to make motion to strike at a later date and further trial continued to Dec. 20, 1955. (Hamlin.)

Dec. 20—Further Court trial. Evidence and exhibits introduced. Motion of defendants to strike from testimony of Poncet Davis granted and further trial continued to Dec. 21, 1955. (Hamlin.)

Dec. 21—Further Court trial. Evidence and exhibits introduced. Motion of defendants for dismissal of first and second causes of action submitted. Memos. to be filed by counsel before Jan. 4, 1956, \* \* \* and further trial continued to Jan. 4, 1956. (Hamlin.) \* \* \* \* \*

1956

Jan. 3—Filed amendments to answer of defendants, with order granting leave to amend. (Hamlin.)

\* \* \* \* \*

Jan. 4—Further Court trial. Evidence and exhibits introduced and further trial continued to Jan. 5, 1956. (Hamlin.)

Jan. 5—Further Court trial. Evidence and exhibits introduced and further trial continued to Jan. 6, 1956. (Hamlin.)

Jan. 6—Further Court trial. Evidence and exhibits introduced, memos ordered filed 10-10-5 days and case continued to Feb. 3, 1956 for further trial. (Hamlin.)

\* \* \* \* \*

1956

Feb. 2—Filed stipulation & order re income tax returns.

\* \* \* \* \*

Mar. 2—Ordered after arguments case submitted.  
(Hamlin.)

Mar. 20—Filed order for judgment for defendants. Counsel to prepare findings, conclusions and judgment. Findings & Conclusions to contain specific items as set out.

\* \* \* \* \*

Mar. 29—Filed reporter's transcript of proceedings March 2, 1956.

Apr. 10—Lodged judgment by deft.

Apr. 10—Lodged findings and conclusions by deft.

Apr. 12—Filed stipulation and order extending time for plaintiff to object to form of judgment, findings and conclusions and to serve and lodge proposed modifications to April 30, 1956. (Hamlin.)

Apr. 19—Filed reporter's transcript of proceedings Dec. 12, 16, 19, 20, 21, 1955, Jan. 4, 5 and 6, 1956.

Apr. 30—Filed proposed modifications to findings and conclusions, by plaintiff.

May 11—Filed objections of defendants to proposed findings and conclusions of plaintiff (letter).

May 22—Filed memorandum of corrections to reporters' transcript of proceedings.

May 22—Filed supplemental memo (letter) of deft. re transcript.

May 22—Filed findings and conclusions.

May 22—Entered judgment—filed May 22, 1956—

May 22, 1956—(Cont.)

complaint dismissed on merits and defendants to recover costs. (Hamlin.) \* \* \* \* \*

May 28—Filed memo. of costs by defendants (\$574.57).

May 31—Costs taxed \$249.57. (Clerk.)

June 6—Filed notice of appeal by plaintiff.

June 6—Filed appeal bond in sum \$250.00 (cash deposited in registry).

June 6—Filed appellant's designation of record on appeal.

---

[Title of District Court and Cause.]

**COMPLAINT FOR DAMAGES, BREACH OF  
TRUST AND AN ACCOUNTING, AND IN  
THE ALTERNATIVE TO RECOVER AS-  
SETS OF CORPORATION**

Plaintiff, Robbins Tire and Rubber Company, Incorporated, complains of defendants and avers as follows:

**Count One**

1. Plaintiff, Robbins Tire and Rubber Company, Incorporated, is a corporation incorporated under the laws of the State of Alabama, with its principal office in the County of Colbert, State of Alabama.

2. Defendant Bay Rubber Company is a limited copartnership doing business in the State of California.

3. Defendants Edwin W. Pauley and C. L. Cameron are citizens and residents of the State of California and are the general partners of defendant Bay Rubber Company.

4. Defendants Wesley H. DeSellem and John B. Condrey are citizens and residents of the State of California, residing in the Northern Judicial District of the State of California.

5. The matter in controversy herein exceeds the sum or value of \$3,000, exclusive of interest and costs.

6. At all times after January 1, 1949, plaintiff was the owner of 41.403 per cent of all the issued and outstanding stock of Pacific Rubber Company, a California corporation.

7. At all times after January 1, 1949, defendants DeSellem and Condrey were, and they now are, directors of said Pacific Rubber Company and trustees for plaintiff as hereinafter averred.

8. On or about January 5, 1951, the owners of all the issued and outstanding shares of stock of said Pacific Rubber Company agreed in writing to dissolve and liquidate said corporation and to transfer all its assets to its stockholders, one of which is and was plaintiff herein as aforesaid, in a meeting duly called and convened for said purpose. Defendants Pauley, DeSellem, Condrey and Cameron were informed of said resolution on or about the date of its adoption.

9. At the time of the adoption of said resolution referred to in paragraph 8 herein there were among the assets of said Pacific Rubber Company two agreements, one dated August 28, 1950, between Reconstruction Finance Corporation on the one hand, and Pacific Rubber Company and Minnesota Mining and Manufacturing Company on the other hand, providing for the operation by Minnesota Mining and Manufacturing Company of a synthetic rubber plant located at Torrance, California, and one dated September 20, 1950, between Minnesota Mining and Manufacturing Company and Pacific Rubber Company. Said assets exceed in value the sum of \$1,000,000.

10. Plaintiff is informed and believes that on or about January 15, 1951, said assets came into the possession of defendants Condrey and DeSellem who thereupon held said assets as trustees for and with knowledge of and subject to the rights of this plaintiff.

11. Plaintiff is informed and believes and therefore avers that on or about May 21, 1951, without authority, notice to, or knowledge of plaintiff, defendants Condrey, DeSellem, Cameron, Pauley and Bay Rubber Company, conspired and agreed to transfer and did transfer the assets hereinabove described in paragraph 9 to defendant Bay Rubber Company in violation of plaintiff's rights as the beneficial owner of said assets, and that defendant Pauley, as general partner of defendant Bay Rubber Company, accepted said assets knowing of plaintiff's rights to said assets, as hereinabove set forth.

12. Plaintiff is informed and believes and therefore avers that from May, 1951, to the present time, defendants have received and are continuing to receive on account of the assets hereinabove described in paragraph 9 sums of money in excess of \$20,000 per month, 41.403 per cent of which said sums has been and is now held by defendants for the benefit of plaintiff and none of which has been received by plaintiff.

13. Plaintiff is informed and believes and therefore avers that there were other assets of Pacific Rubber Company on or about January 15, 1951, which came into the possession of defendants Condrey, DeSellem and Cameron with knowledge of and subject to the rights of plaintiff for which defendants Condrey and DeSellem have not accounted to this plaintiff.

14. Defendants Pauley, Cameron and Bay Rubber Company participated and aided in the breaches by defendants Condrey and DeSellem of their duties as trustees for plaintiff as hereinabove set forth by inducing and instructing defendants Condrey and DeSellem to transfer the assets hereinabove described in paragraph 9 to defendant Bay Rubber Company, with knowledge that said transfer was in violation of the duties of Condrey and DeSellem to plaintiff.

15. Defendants Condrey, DeSellem, Pauley, Cameron and Bay Rubber Company conspired and agreed to conceal the possession and transfer of assets described in paragraphs 9 and 13 by said

defendants from the knowledge of plaintiff by purporting to hold a meeting of the directors of Pacific Rubber Company on May 21, 1951, and purporting at said meeting on behalf of Pacific Rubber Company to transfer the assets described in paragraph 9 to defendant Bay Rubber Company for a nominal consideration of \$5,000. Said defendants failed and refused to give notice of said meeting to Glenn A. Taylor, who was then and is now Vice President of plaintiff and who was then a director of Pacific Rubber Company, or to plaintiff. Plaintiff and said Glenn A. Taylor had no knowledge of said meeting at the time it occurred and did not discover that said meeting had occurred until some time in October, 1952. In furtherance of said conspiracy and agreement said defendants from time to time until October, 1952, represented that the assets described in paragraph 9 were being held by defendants Condrey and DeSellem for the benefit of plaintiff. Prior to October, 1952, plaintiff had no knowledge that said assets had been transferred to Bay Rubber Company and that defendants Condrey and DeSellem had purported to transfer said assets worth in excess of \$1,000,000 for the nominal sum of \$5,000.

16. Plaintiff is informed and believes and therefore avers that the defendants sued herein as One Doe, Two Doe, Three Doe, One Doe Corporation, Two Doe Corporation and Three Doe Corporation have received the assets or proceeds of the assets of said stockholders of Pacific Rubber Company with knowledge of and in violation of plaintiff's

rights. Plaintiff herein is ignorant of the true names of said defendants and prays that their true names when discovered be inserted in the record herein in lieu of said fictitious names.

Wherefore, plaintiff prays that:

1. Defendants Condrey and DeSellem be required to account to plaintiff for the assets of said Pacific Rubber Company.
2. Defendants Bay Rubber Company, Pauley, Condrey, DeSellem and Cameron be required to account to plaintiff for the proceeds of said agreements, one dated August 28, 1950, between Reconstruction Finance Corporation on the one hand, and Pacific Rubber Company and Minnesota Mining and Manufacturing Company on the other hand, and one dated September 20, 1950, between Minnesota Mining and Manufacturing Company and Pacific Rubber Company.
3. A trust for the benefit of plaintiff be declared of plaintiff's share of the proceeds from said agreements.
4. Plaintiff be awarded damages in the amount of \$1,000,000 against all defendants, jointly and severally.
5. The Court grant plaintiff such further relief as may be just and equitable in the circumstances.

Count Two in the Alternative

15. Plaintiff hereby refers to and makes a part hereof as though fully set forth herein the averments in paragraphs 1, 2, 3, 4, 5, 6, 7, 8 and 9.

16. Defendant Pacific Rubber Company is a corporation organized and existing under the laws of the State of California and is hereby made a defendant herein.

17. Plaintiff is informed and believes and therefore avers that on or about May 21, 1951, defendants DeSellem and Condrey purported to hold a meeting of the directors of Pacific Rubber Company at which they purported to transfer the assets hereinabove described in paragraph 9 to defendant Bay Rubber Company for the nominal sum of \$5,000 in violation of the rights of Pacific Rubber Company as owner of said assets, and that defendant Pauley, as general partner of defendant Bay Rubber Company, accepted said assets knowing of Pacific Rubber Company's rights to said assets as hereinabove set forth. No notice of said meeting was given to plaintiff or to Glenn A. Taylor, Vice President of plaintiff, who was at the time of the meeting the only director of Pacific Rubber Company in addition to defendants Condrey and DeSellem.

18. Plaintiff is informed and believes and therefore avers that from May, 1951, to the present time, defendant Bay Rubber Company has received and is continuing to receive on account of the assets hereinabove described in paragraph 9 sums of money in excess of \$20,000 per month, all of which said sums are rightfully the property of Pacific Rubber Company and none of which have been received by Pacific Rubber Company.

19. Plaintiff is informed and believes and therefore avers that there are other assets belonging to Pacific Rubber Company which defendants DeSellem and Condrey have transferred to persons unknown to this plaintiff without authority of Pacific Rubber Company.

20. On January 1, 1949, and at all times thereafter, defendants Condrey and DeSellem were, and they now are, a majority of the board of directors of Pacific Rubber Company and during all said time said defendants have been and now are under the domination and control of defendant Pauley. On May 21, 1951, and at all times thereafter Pacific Rubber Company was under a disability and unable to prosecute this action.

21. Plaintiff is informed and believes and therefore avers that the defendants sued herein as One Doe, Two Doe, Three Doe, One Doe Corporation, Two Doe Corporation and Three Doe Corporation have received the assets or proceeds of the assets of said Pacific Rubber Company with knowledge of and in violation of the rights of Pacific Rubber Company. Plaintiff is ignorant of the true names of said defendants and prays that their true names when discovered be inserted in the record herein in lieu of said fictitious names.

22. No demand has been made on the board of directors or other stockholders of Pacific Rubber Company to prosecute this action because defendants DeSellem and Condrey constitute a majority of said board of directors, because defendant Con-

drey is the only stockholder of Pacific Rubber Company other than plaintiff, because defendants DeSellem and Condrey are under the domination and control of defendant Pauley, and because such action would be futile.

23. This action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

Wherefore, plaintiff prays that:

1. Defendants DeSellem and Condrey be required to account to Pacific Rubber Company for the assets of said Pacific Rubber Company.
2. Defendants Bay Rubber Company, Pauley, DeSellem, Condrey and Cameron be required to account to Pacific Rubber Company for the proceeds of said agreements, one dated August 28, 1950, between Reconstruction Finance Corporation on the one hand, and Pacific Rubber Company and Minnesota Mining and Manufacturing Company on the other hand, and one dated September 20, 1950, between Minnesota Mining and Manufacturing Company and Pacific Rubber Company.
3. A constructive trust for the benefit of Pacific Rubber Company be declared of Pacific Rubber Company's share of the proceeds from said agreements.
4. Plaintiff be reimbursed in the sum of \$100,000 for costs and attorneys' fees in prosecuting this action.

5. The Court grant such further relief as may be just and equitable in the circumstances.

/s/ GEORGE BOUCHARD,  
/s/ BOUCHARD & LITTLE,  
/s/ JAMES C. HERNDON,  
Attorneys for Plaintiff.

[Endorsed]: Filed December 14, 1954.

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[Title of District Court and Cause.]

**ANSWER OF THE DEFENDANT, BAY RUBBER COMPANY, A LIMITED CO-PARTNERSHIP**

Comes now the Defendant, Bay Rubber Company, a limited Co-partnership, (hereinafter to be referred to as "Bay") and, severing from its co-defendants and answering for itself alone, for answer to Plaintiff's Complaint on file herein, admits, denies and avers as follows:

**For Answer to Count One**

1. Defendant Bay admits the allegations contained in paragraphs 1, 2 and 3 of Plaintiff's Complaint on file herein.

2. Defendant Bay admits that the Defendants, Wesley H. DeSellem, (hereinafter to be referred to as "DeSellem), and John B. Condrey, (hereinafter to be referred to as "Condrey"), are citizens and residents of the State of California as alleged in paragraph 4 of Plaintiff's Complaint, but has no information or belief sufficient to enable it to

answer the remaining allegations of said paragraph, and upon that ground, denies, generally and specifically, each and every, all and sundry, the remaining allegations therein contained.

3. Defendant Bay admits the allegations contained in paragraphs 5 and 6 of Plaintiff's Complaint, and in this regard alleges that Plaintiff at all times since January, 1949, was and now is the legal owner of 41.403 per cent of the issued and outstanding stock of Defendant Pacific Rubber Company, (hereinafter referred to as "Pacific"), but alleges that said Plaintiff at all times since January, 1949, was and now is the alter-ego of one Ponce Davis, (hereinafter referred to as "Davis"), who at all times since January, 1949, was and now is the beneficial owner of said stock, and who at all times since January 8, 1951, was and now is also the legal and beneficial owner of 36 per cent of Defendant Bay.

4. In answer to paragraph 7 of Plaintiff's Complaint, Defendant Bay admits that Defendants, DeSellem and Condrey, at all times from and after January 1, 1949, were and now are, two of the three Directors of the Defendant Pacific but denies, generally and specifically, each and every, all and sundry, the remaining allegations of said paragraph.

5. In answer to paragraph 8 of Plaintiff's Complaint, Defendant Bay admits that on or about January 5, 1951, the owners of all of the issued and outstanding shares of stock of Defendant Pa-

cific (including Plaintiff herein) at a Special Stockholders' Meeting duly called upon notice and held for that purpose, voted to wind up and dissolve the Defendant Pacific and authorized and directed the officers and directors of said Company to take such action as might be necessary and proper to wind up the affairs and dissolve the Company. Defendant Bay has no information or belief sufficient to enable it to answer the remaining allegations of said paragraph, and upon that ground denies, generally and specifically, each and every, all and sundry, said remaining allegations.

6. In answer to paragraph 9 of Plaintiff's Complaint, Defendant Bay admits that at the time of the adoption of the foregoing shareholders' resolution, there were among the assets of Defendant Pacific, three agreements, one dated August 28, 1950, between Reconstruction Finance Corporation, (hereinafter referred to as "RFC"), on one hand, and Defendant Pacific and Minnesota Mining and Manufacturing Company, (the interest of which was subsequently assigned to Midland Rubber Company, a corporation, and which will accordingly hereinafter be referred to as "Midland"), on the other hand, providing for the operation by Midland of a Synthetic Rubber Plant owned by RFC and located at Torrance, California, (which agreement will hereinafter be referred to as the "RFC-Pacific agreement"); and the other two dated September 20, 1950, between Midland and Defendant Pacific, one of which provided for the operation of said Synthetic Rubber Plant, the division of the man-

agement fee, the performance of certain obligations by Defendant Pacific, and assumption by Defendant Pacific of 35 per cent of any liability incurred by Midland for injury to or death of persons or damage to property arising out of or connected with performance of said RFC-Pacific agreement, for which Midland would not be reimbursed by RFC, (which said agreement will hereinafter be referred to as the "M-P Agreement"), and the other setting forth the respective rights and duties of Midland and Defendant Pacific with regard to inventions and patent rights, (which said agreement will hereinafter be referred to as the "Patent Agreement"), but denies, generally and specifically, each and every, all and sundry, the remaining allegations of said paragraph, and denies that said assets at the time of the adoption of such resolution or at the time of the subsequent transfer of said assets to Defendant Bay were of the value of One Million Dollars (\$1,000,000.00) or of any value in excess of the consideration given therefor by Defendant Bay to Defendant Pacific.

7. Defendant Bay denies, generally and specifically, each and every, all and sundry, the allegations contained in paragraph 10 of Plaintiff's Complaint.

8. In answer to paragraph 11 of Plaintiff's Complaint, Defendant Bay admits that on or about May 21, 1951, it received the assets described in paragraph 6 of this answer by way of written Assignment from Defendant Pacific, which Assign-

ment provided that said transfer was to become effective retroactive to January 15, 1951. In this respect, it alleges that a valuable and substantial consideration was given for said assets and denies, generally and specifically, each and every, all and sundry, the remaining allegations in said paragraph contained.

9. In answer to paragraph 12 of Plaintiff's Complaint, Defendant Bay admits that it has received from time to time, since September, 1951, income under the agreements referred to in paragraph 6 of this answer, and in this regard, alleges that said income from January 15, 1951, the date upon which the Assignment to Defendant Bay became effective, to the date hereof has averaged approximately Fourteen Thousand Dollars (\$14,000.00) per month; and denies, generally and specifically, each and every, all and sundry, the remaining allegations of said paragraph.

10. Defendant Bay has no information or belief sufficient to enable it to answer the allegations contained in paragraph 13 of Plaintiff's Complaint and upon this ground, denies, generally and specifically, each and every, all and sundry, the allegations therein contained.

11. Defendant Bay denies, generally and specifically, each and every, all and sundry, the allegations contained in paragraph 14 of Plaintiff's Complaint.

12. Defendant Bay denies, generally and specifically, each and every, all and sundry, the allegations

contained in paragraph 15 of Plaintiff's Complaint; but admits that the agreements referred to in paragraph 6 of this answer were assigned to Defendant Bay, averring in this respect that said Assignment was made for an adequate consideration, to wit: Five Thousand Dollars (\$5,000.00), and the assumption by Bay of Defendant Pacific's obligations under the M-P Agreement and Patent Agreement, including a certain contingent liability of Defendant Pacific to Midland, as described in paragraph 6 hereof.

13. Defendant Bay has no information or belief sufficient to enable it to answer the allegations as set forth in paragraph 16 of Plaintiff's Complaint, and upon that ground denies, generally and specifically, each and every, all and sundry, the allegations therein contained.

Wherefore, Defendant Bay prays that Plaintiff take nothing by reason of Count One of its Complaint on file herein and that the same be dismissed and that Defendant Bay be awarded its costs of suit and such other and further relief as to the Court seems just and proper.

#### For Answer to Count Two

14. Defendant Bay refers and makes reference to the answers which it has heretofore made to paragraphs 1, 2, 3, 4, 5, 6, 7, 8 and 9 of Count One of Plaintiff's Complaint and realleges said answers as though herein more fully set forth.

15. In answer to paragraph 17, Count Two of

Plaintiff's Complaint, Defendant Bay admits that on May 21, 1951, a meeting of the Board of Directors of Defendant Pacific was duly and regularly held and that such meeting authorized the transfer and assignment of Defendant Pacific's interest in the agreements described in paragraph 6 of this answer to Defendant Bay, and in this regard Defendant Bay alleges that it gave Defendant Pacific an adequate consideration for the assignment of said agreements, to wit: The sum of Five Thousand Dollars (\$5,000.00), and the assumption by Defendant Bay of all Defendant Pacific's obligations under said agreements, including Defendant Pacific's obligation to contribute to Midland 35 per cent of any liability incurred by Midland for injury to or death of persons or damage to property arising out of or connected with the performance of the aforesaid RFC-Pacific Agreement, where Midland was not to be reimbursed for said liability by RFC. Defendant Bay admits that no notice of said meeting was given to Plaintiff or to Glenn A. Taylor, Vice President of Plaintiff, and in this regard alleges that said meeting of the Board of Directors was a regular meeting duly and regularly held in accordance with the Bylaws of Defendant Pacific and no notice was required; and denies, generally and specifically, each and every, all and sundry, the remaining allegations of said paragraph.

16. Defendant Bay denies, generally and specifically, each and every, all and sundry, the allegations contained in paragraph 18, Count Two, of Plaintiff's Complaint; except that Defendant Bay

admits having received income from the agreements so assigned to it on and after January 15, 1951, the date upon which said assignment to Defendant Bay became effective, which income has been in an average amount of approximately Fourteen Thousand Dollars (\$14,000.00) per month, and alleges that Defendant Pacific received income on account of said assets for the month of December 1950, and for the period January 1 to January 14, 1951.

17. In answer to paragraph 19, Count Two, of Plaintiff's Complaint, Defendant Bay alleges that it has no information or belief sufficient to enable it to answer the allegations therein contained and upon that ground denies, generally and specifically, each and every, all and sundry, said allegations.

18. In answer to paragraph 20, Count Two, of Plaintiff's Complaint, Defendant Bay admits that on January 1, 1949, and at all times thereafter, Defendants Condrey and DeSellem were are now are two of the three Directors of Defendant Pacific, and alleges that the remaining Director was at all such times and now is one, Glenn A. Taylor, who was at all times and now is dominated and controlled by Plaintiff herein, and denies that Defendants Condrey and DeSellem or either of them ever have been or now are under the domination or control of the Defendant Pauley; and alleges that Defendant Bay has no information or belief sufficient to enable it to answer the remaining allegations of said paragraph and upon that ground denies, generally and specifically, each and every, all and sundry, said remaining allegations.

19. In answer to paragraph 21, Count Two, of Plaintiff's Complaint, Defendant Bay alleges that it has no information or belief sufficient to enable it to answer the allegations therein contained and upon that ground denies, generally and specifically, each and every, all and sundry, said allegations.

20. In answer to paragraph 22, Count Two, of Plaintiff's Complaint, Defendant Bay is informed and believes that neither Plaintiff Robbins Tire and Rubber Company, Incorporated, (hereinafter referred to as "Robbins"), nor Davis made any demand upon the Board of Directors or other stockholders of Defendant Pacific to prosecute this action; admits that Defendants Condrey and DeSellem constitute a majority of the Board of Directors of Defendant Pacific; admits that Defendant Condrey is the only stockholder of Defendant Pacific, other than Plaintiff; denies, generally and specifically, each and every, all and sundry, the remaining allegations of said paragraph.

21. In answer to paragraph 23, Count Two, of Plaintiff's Complaint, Defendant Bay alleges that it lacks information or belief sufficient to enable it to answer the allegations therein contained and upon that ground denies, generally and specifically, each and every, all and sundry, said allegations.

Wherefore, Defendant Bay prays that Plaintiff take nothing by reason of Count Two of its Complaint on file herein, that the same be dismissed and Defendant Bay be awarded its costs of suit and such other and further relief as to the Court may seem just and proper.

For Further, Separate, and First Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

22. Defendant Pacific at all times herein mentioned was and now is a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal place of business in Oakland, California, having been duly incorporated on December 28, 1948. All of the issued and outstanding stock of Defendant Pacific at all times herein mentioned has been and now is owned by Plaintiff Robbins Tire and Rubber Company, Incorporated, (hereinafter referred to as "Robbins"), and by Defendant Condrey in the following percentages: Robbins—41.403 per cent; Condrey—58.597 per cent.

23. Plaintiff Robbins at all times herein mentioned was and now is a corporation duly organized and existing under and by virtue of the laws of the State of Alabama, with its principal place of business in Tuscumbia, Alabama. Defendant Bay is informed and believes and relying upon such information and belief, alleges that one, Davis, at all times herein mentioned has been and now is the President of Plaintiff corporation and owner of all of the issued and outstanding stock of said corporation and now dominates and controls and has at all times herein mentioned dominated and controlled all of its affairs.

24. On January 7, 1951, Inland Rubber Corpo-

ration (hereinafter referred to as "Inland"), Defendant Edwin W. Pauley (hereinafter referred to as "Pauley"), William R. Pagen, Trustee (hereinafter referred to as "Pagen"), and Davis, Trustee for Poncet Davis, Jr. and Katherine "Trinka" Davis, entered into two written Agreements, one of which agreements provided for the formation of a new corporation, to be known as Pacific Tire and Rubber Company, to purchase the assets of Defendant Pacific, and further provided for the formation of a Limited Partnership to be known as Bay Rubber Company (Defendant herein) by Pauley, Pagen and Davis, which persons would own interests in Defendant Bay in the following proportions: Pauley—51 per cent; Pagen, Trustee—14 per cent; and Davis, Trustee—35 per cent; and that said Pacific Tire and Rubber Company would issue stock and debenture notes one-half of which would be owned by Defendant Bay and the remaining one-half of which would be owned by Inland; and the second of which agreements provided in substance as follows: That whereas Defendant Condrey and Plaintiff Robbins, the owners of all of the issued and outstanding stock of Defendant Pacific, desire to dissolve Pacific and sell the assets thereof, and whereas Inland, Pauley and Davis, as Trustee, were willing to form a new corporation to be known as Pacific Tire and Rubber Company, which would purchase certain assets of Defendant Pacific, that Plaintiff Robbins and Defendant Condrey would, on the closing date, transfer to said new corporation for valuable consideration certain assets of

Defendant Pacific which had been distributed to them by virtue of dissolution of Defendant Pacific. Said second agreement expressly stated that the agreements described in paragraph 6 of this Answer (designated as the RFC-Pacific Agreement, the "M-P Agreement" and the "Patent Agreement") were not to be assigned and transferred to said new corporation. A copy of said first agreement dated January 7, 1951, is attached hereto and by reference made a part hereof and marked "Exhibit A" and a copy of said second agreement dated January 7, 1951, is attached hereto and by reference made a part hereof and marked "Exhibit B."

25. On or about January 8, 1951, pursuant to said agreements of January 7, 1951, referred to in paragraph 24 hereof, Defendant Bay was organized as a Limited Partnership under the laws of the State of California, and ever since said date has been and now is operating as a Limited Partnership with its principal place of business in Los Angeles, California. At the time of the initial organization of said Limited Partnership Defendant Pauley was the only General Partner thereof, and Davis, as Trustee, Pagen, as Trustee, Earl W. Booz (hereinafter referred to as "Booz"), Defendant Condrey, Defendant C. L. Cameron (hereinafter referred to as "Cameron") and Orris R. Hedges (hereinafter referred to as "Hedges") were the Limited Partners thereof. The interest of said Partners in said Partnership at the time of its initial organization was as follows: Defendant Pauley—51 per cent; Davis, Trustee—35 per cent; Pagen,

Trustee—10 per cent; Booz—1 per cent; Defendant Condrey—1 per cent; Defendant Cameron—1 per cent; and Hedges—1 per cent. Thereafter and on or about December 28, 1951, the agreement for said Limited Partnership was amended in the following particulars: Defendant Cameron became a General Partner with the Defendant Pauley, in said Limited Partnership, and a portion of the interest of Pagen, Trustee, was assigned, with consent of all of the Partners, to Donald R. Macpherson (hereinafter referred to as "Macpherson"), J. L. Hayes (hereinafter referred to as "Hayes") Hayes, as Trustee, and Davis, as Trustee. As a result of such transfer of partnership interests, the interests of said parties in said Partnership were readjusted as follows: Defendant Pauley—51 per cent; Davis, Trustee—36 per cent; Booz—1 per cent; Defendant Condrey—1 per cent; Defendant Cameron—1 per cent; Hedges—1 per cent; Macpherson— $\frac{1}{2}$  per cent; Pagen— $\frac{1}{2}$  per cent; Hayes—4 per cent; and Hayes, Trustee—4 per cent. Said Articles of Partnership as amended further provided that the General Partner Defendant Pauley would contribute to the capital of the Partnership the sum of Seventy-Six Thousand Five Hundred Dollars (\$76,500.00), that General Partner Defendant Cameron would contribute to said capital the sum of Fifteen Hundred Dollars (\$1,500.00), that Limited Partner Davis, Trustee, would contribute to said capital the sum of Fifty-Four Thousand Dollars (\$54,000.00), that Limited Partners Hayes and Hayes, Trustee, would each contribute to said cap-

ital the sum of Six Thousand dollars (\$6,000.00), that Limited Partners Booz, Defendant Condrey, and Hedges would each contribute to said capital the sum of Fifteen Hundred Dollars (\$1,500.00), and that Limited Partners Macpherson and Pagen would each contribute to said capital the sum of Seven Hundred and Fifty Dollars (\$750.00). Said Articles of Partnership as amended further provided that in the event additional capital of One Hundred Fifty Thousand Dollars (\$150,000.00) should be required, on or after July 1, 1951, each of the Partners would contribute additional capital in the proportion that each Partner's interest bore to the total sum of One Hundred Fifty Thousand Dollars (\$150,000.00).

26. Defendant Bay is informed and believes and relying upon such information and belief alleges that the said Davis now is and always has been the true and beneficial owner of the entire 36 per cent interest in said Limited Partnership allegedly held by him as Trustee, and described in paragraph 25 of this Answer as held by Davis, Trustee.

27. Subsequent to July 1, 1951, and prior to the filing of this action, additional capital was in fact required for the operation of Defendant Bay and demands were made upon each Partner for his proportionate share of the sum of One Hundred Fifty Thousand Dollars (\$150,000.00). Each Partner except Davis thereafter offered to contribute his proportionate share. Upon Davis' refusal to contribute his said share, Defendant Bay insti-

tuted suit against Davis in the United States District Court for the Northern District of Ohio, Eastern Division Docket No. 30798, to compel payment of his share of said contribution, and said action is now pending before said Court.

28. On or about January 5, 1951, pursuant to Notice duly and regularly given, a Special Meeting of the Shareholders of Defendant Pacific was held at the Company's offices in Oakland, California, at which time, Defendant Bay is informed and believes and relying upon such information and belief alleges that Davis, one Glenn A. Taylor, as Attorney-in-Fact for Plaintiff Robbins, and Defendant Condry were present. At said meeting a resolution was unanimously adopted by the Shareholders providing that Defendant Pacific would wind up its affairs and voluntarily dissolve and that its Officers and Directors were authorized to take such action as they might deem necessary or proper to wind up the affairs of said corporation and dissolve it.

29. Defendant Bay is informed and believes and relying upon such information and belief alleges that thereafter, on or about May 21, 1951, at a regular meeting of the Board of Directors of Defendant Pacific, duly held and convened at its offices in Oakland, California, said Board adopted a resolution authorizing the transfer and assignment of certain agreements to Defendant Bay, namely: that certain Agreement dated August 28, 1950, between Midland, Defendant Pacific and Reconstruction Finance Corporation, hereinabove re-

ferred to in paragraph 6 of this Answer as the RFC-Pacific Agreement, that certain agreement dated September 20, 1950, between Midland and Defendant Pacific, hereinabove referred to in paragraph 6 of this Answer as the "M-P Agreement" and that certain agreement dated September 20, 1950, between Midland and Defendant Pacific, hereinabove referred to in paragraph 6 of this Answer as the "Patent Agreement." The consideration for such transfer and assignment was the sum of Five Thousand Dollars (\$5,000.00), and the assumption by the Defendant Bay of the obligations and liabilities of the Defendant Pacific to Midland under said agreements, including an obligation to contribute to Midland 35 per cent of any liability incurred by Midland for injury or death to persons or damages to property arising out of operations under said RFC-Pacific Agreement for which Midland was not reimbursed by RFC.

30. Defendant Bay is informed and believes and relying on such information and belief alleges that at all times on and after January 7, 1951, Plaintiff Robbins, its President, Davis and its Authorized Agent, one George Bouchard (hereinafter referred to as "Bouchard"), and each of them, well knew and were fully advised and it was a fact that the aforesaid RFC-Pacific Agreement of August 28, 1950, and the aforesaid M-P and Patent Agreements of September 20, 1950, could not be transferred and assigned by Defendant Pacific to its stockholders, Defendant Condrey and Plaintiff Robbins, because neither RFC nor Midland would ac-

cept Defendant Condrey or Plaintiff Robbins as parties to said agreements; that Plaintiff Robbins was not in good standing with Reconstruction Finance Corporation and would not be accepted as assignee of Defendant Pacific's interest in said agreements; that Midland was likewise unwilling to accept Plaintiff Robbins as assignee of Defendant Pacific's interest in said agreements; that the only other shareholder of Defendant Pacific, to-wit: Defendant Condrey, was an individual not qualified under the standards established by RFC for participation in said agreements in that he could not qualify as an Operating Rubber Company, and that Defendant Pacific, in order to wind up its affairs and dissolve and to distribute its assets to its shareholders was required by law to make adequate provisions for payment of its debts and fulfillment or assumption of its liabilities. Defendant Bay is informed and believes and relying on such information and belief alleges that at all times on and after January 9, 1951, Plaintiff Robbins and the said Davis and Bouchard, and each of them, well knew and were fully advised, and it was a fact that among the liabilities of the Defendant Pacific were certain obligations created under the aforesaid M-P Agreement and Patent Agreement with Midland, including an obligation to contribute to Midland 35 per cent of any liability incurred by Midland on account of injury to or death of persons or damage to property arising out of or connected with performance of the aforesaid RFC-Pacific Agreement for which Midland,

would not be reimbursed by RFC; that Midland was unwilling to and did not accept Defendant Pacific as a participant in said RFC-Pacific Agreement unless and until Defendant Pauley guaranteed the aforesaid obligations and liabilities of Defendant Pacific to Midland, and that Defendant Pauley did, in fact, give such a guarantee to Midland to enable Defendant Pacific to participate in said Agreements; that at the time of winding up and dissolution of Defendant Pacific, Defendant Bay was the only party available and believed to be qualified to assume the interest and obligations of Defendant Pacific under the aforesaid agreements, but that Midland was unwilling to accept the sole liability of Defendant Bay for the performance of Defendant Pacific's covenants and obligations under the aforesaid agreements, and that at the time said agreements were transferred and assigned by Defendant Pacific to Defendant Bay, Defendant Pauley was required by Midland as a condition of Midland's consent to such transfer to guarantee, and did guarantee in writing, the assumed liability of Defendant Bay to Midland.

31. Defendant Bay is informed and believes and relying on such information and belief alleges that at all times on and after January 5, 1951, Plaintiff Robbins and the said Davis and Bouchard and each of them, were fully advised and well knew and it was a fact that the interest of Defendant Pacific in said RFC-Pacific Agreement of August 28, 1950, and in said M-P and Patent Agreements of September 20, 1950, would be transferred by

Defendant Pacific to Defendant Bay for a consideration of Five Thousand Dollars (\$5,000.00) and the assumption by Bay of all Pacific's liabilities and obligations thereunder.

32. Defendant Bay is informed and believes and relying on such information and belief alleges that at all times on and after May 21, 1951, Plaintiff Robbins and the said Davis and Bouchard, and each of them, were fully advised and well knew, and it was a fact that said agreements of August 28, 1950, and September 20, 1950, had been transferred and assigned by Defendant Pacific to Defendant Bay for a consideration of Five Thousand Dollars (\$5,000.00) and the assumption by Bay of all of Pacific's liabilities and obligations thereunder.

33. Defendant Bay is informed and believes and relying on such information and belief alleges that Plaintiff Robbins and the said Davis and Bouchard, and each of them, at all times on and after January 9, 1951, were fully advised and well knew, and it was a fact that the assets of Defendant Bay consisted solely of one-half of the issued and outstanding stock of Pacific Tire and Rubber Company, a corporation, a one-half interest in certain debenture notes issued by said corporation, and Bay's assigned interest under the aforesaid RFC-Pacific Agreement of August 28, 1950, and under the M-P and Patent Agreements of September 20, 1950.

34. Defendant Bay is informed and believes and relying on such information and belief alleges that

at all times on and after May 21, 1951, Plaintiff Robbins and the said Davis and Bouchard, and each of them, were fully advised and well knew and it was a fact that the only income being received by Defendant Bay and the only funds of Bay from which cash distributions could have been made were derived from Bay's income from said agreements.

35. At divers times in and after the month of September, 1951, the said Davis, without any objection whatsoever, accepted benefits arising from said agreements dated August 28, 1950 and September 20, 1950 which had been so transferred and assigned to Defendant Bay, in that the said Davis received certain cash distributions from Defendant Bay, and, as a Limited Partner in Defendant Bay, was credited with 36 per cent of all income received by said Defendant from Midland as its share of the management fee under said agreements. All of such management fee distributions to Defendant Bay and cash distributions and credits to the said Davis, as well as Defendant Bay's ownership of said assigned agreements, were reflected on the face of periodic balance sheets and profit and loss statements issued by Defendant Bay, copies of which were transmitted to and received by the said Davis, at semi-annual or annual intervals, commencing December 31, 1951.

36. Neither the said Davis nor Plaintiff Robbins at any time made any objection to any of the aforesaid credits to the account of Davis or to any of

the aforesaid cash distributions to Davis by Defendant Bay, or to the transfer of said synthetic rubber contracts by Defendant Pacific to Defendant Bay or to the consideration given for such transfer as aforesaid until approximately two months before the filing of this action.

37. Plaintiff Robbins has failed to state a cause of action against any of defendants in that both Robbins and its sole and beneficial owner Davis with full knowledge thereof participated in, consented to and ratified all of the transactions on which the complaint is based, and the said Davis participated in and received benefits from such transactions without any objection whatsoever until two months before the filing of this action.

For a Further, Separate, and Second Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

38. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

39. At no time mentioned in Plaintiff's Complaint did Defendant Bay conspire with Defendants Condrey, DeSellem, Cameron or Pauley, or any of them, or with any other person, firm or corporation, to transfer the assets of Defendant Pacific described in paragraph 6 of this Answer, or any other assets of Defendant Pacific to Defendant Bay

to the damage of Plaintiff Robbins, or any other person.

40. None of the actions of Defendant Condrey or Defendant DeSellem described in Plaintiff's Complaint were in breach of any duty of said Defendants to Plaintiff herein, or to any other person, firm or corporation.

41. Defendant Bay alleges that each and every act which it performed in connection with the transfer and assignment of the said RFC-Pacific Agreement, M-P Agreement and Patent Agreement to itself was for the best interest of Plaintiff Robbins, its sole and beneficial owner, Davis, and Defendant Condrey, the shareholders of Defendant Pacific, and each of them, and was performed with the full knowledge, consent of and subsequent ratification of each of said shareholders.

For a Further, Separate, and Third Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

42. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

43. Plaintiff Robbins is estopped from maintaining this action or claiming the relief sought in this Complaint because neither it nor its sole and beneficial owner, Davis, made any objection to the transfer of Defendant Pacific's interest in the said RFC-

Pacific Agreement, M-P Agreement or Patent Agreement to Defendant Bay at any time prior to the transfer thereof to Defendant Bay on May 21, 1951, or at any time after such transfer until approximately two months before the filing of this action. Because of the failure of Plaintiff Robbins, or its sole and beneficial owner, Davis, to object to any of such acts or transactions and in reliance on their silence, Defendant Bay on May 21, 1951, assumed all of the obligations of Defendant Pacific under said agreements and paid the sum of Five Thousand Dollars (\$5,000.00) to Defendant Pacific for its interest in said agreements, and ever since said date has been and is now performing all of its said assumed obligations.

44. In reliance upon the transfer of said agreements by Defendant Pacific to Defendant Bay, and because of the failure of Plaintiff Robbins, or its sole and beneficial owner, Davis, to make any objections to said transfer, on or about the 29th day of June, 1951, Defendant Bay and Midland cancelled and terminated said M-P Agreement and Patent Agreement and substituted therefor new agreements between Midland and Defendant Bay, which agreements ever since that date, have been and now are in effect. Ever since said date Defendant Bay has been and now is performing its obligations under said new agreements and has participated in said RFC-Pacific Agreement with Midland in reliance upon the assignment and transfer to it of Pacific's interest under said cancelled agreements.

For a Further, Separate, and Fourth Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

45. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense and the allegations of paragraph 44 of its Third Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

46. Plaintiff Robbins waived its right to maintain this action or to claim the relief sought in this Complaint because neither it nor its sole and beneficial owner, Davis, made any objection to the transfer of Defendant Pacific's interest in the said RFC-Pacific Agreement, M-P Agreement or Patent Agreement to Defendant Bay at any time prior to the transfer thereof to Defendant Bay on May 21, 1951, or at any time after such transfer until approximately two months before the filing of this action. Because of the failure of Plaintiff Robbins, or its sole and beneficial owner, Davis, to object to any of such acts or transactions and in reliance on their silence, Defendant Bay on May 21, 1951, assumed all of the obligations of Defendant Pacific under said agreements and paid the sum of Five Thousand Dollars (\$5,000.00) to Defendant Pacific or its interest in said agreements, and ever since said date has been and is now performing all of its said assumed obligations.

47. By reason of the aforesaid premises, Plaintiff has waived its right to maintain this action, or

to claim the relief sought in the Complaint on file herein.

For a Further, Separate, and Fifth Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

48. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense and the allegations of paragraph 44 of its Third Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

49. Neither Plaintiff Robbins nor its sole and beneficial owner, Davis, made any objection to the transfer of Defendant Pacific's interest in the said RFC-Pacific Agreement, M-P Agreement or Patent Agreement to Defendant Bay, at any time prior to the transfer thereof to Defendant Bay on May 21, 1951, or at any time after such transfer until approximately two months before the filing of this action. Because of the failure of Plaintiff Robbins, or its sole and beneficial owner, Davis, to object to any of such acts or transactions and in reliance on their silence, Defendant Bay on May 21, 1951, assumed all of the obligations of Defendant Pacific under said agreements and paid the sum of Five Thousand Dollars (\$5,000.00) to Defendant Pacific for its interest in said agreements, and ever since said date has been and is now performing all of its said assumed obligations.

50. Plaintiff Robbins, in spite of its participation, as aforesaid, in the transfer of said RFC-

Pacific Agreement, M-P Agreement and Patent Agreement to Defendant Bay, and in spite of its full knowledge of all of the facts surrounding such transfer and assignment, including knowledge of the consideration given therefor by Defendant Bay, failed to commence any action or proceeding questioning the validity of such transfer, or the adequacy of the consideration given therefor, or to request an accounting for the proceeds of such agreements, or to recover damages for the transfer thereof, or to obtain any of the relief sought in the Complaint on file herein until the institution of this action.

51. If Defendant Bay is now required to account for the proceeds of the transfer of said agreements, it will be gravely prejudiced in that in reliance upon said transfer, ever since May 21, 1951, the date on which such transfer was made, it has performed and now is performing duties and has fulfilled and now is fulfilling obligations under said M-P Agreement and Patent Agreement, and the two agreements with Midland substituted therefor, and referred to in paragraph 44 of this Answer; Defendant Bay has also distributed funds paid to it by Midland, as Bay's share of the management fee under said agreements, to the Partners in Bay (including the said Davis) in reliance on the validity of said transfer.

52. Plaintiff Robbins has therefore been guilty of Laches in failing to file, or prosecute an action to obtain the relief sought herein, and such Laches ought to and does bar this action.

For a Further, Separate, and Sixth Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

53. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

54. The causes of action set forth in Plaintiff's Complaint, and each of them, accrued more than three (3) years prior to the filing of this action and Plaintiff had knowledge of the facts upon which said causes of action and each of them are based more than three years before the filing of this action. Each of said causes of action is therefore barred by the provisions of Section 338 (4) and Section 339 (1) of the Code of Civil Procedure of the State of California.

For a Further, Separate, and Seventh Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

55. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

56. Defendant Bay is informed and believes and relying upon such information and belief alleges that Plaintiff corporation is wholly owned and completely dominated and controlled by one Davis, and is the alter-ego of said Davis. Said Davis is the

real party in interest herein. There is a defect of parties to this action in that said Davis has not been named either as a party Plaintiff or a party Defendant and is an indispensable party to a complete determination of the action.

For a Further, Separate, and Eighth Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

57. Defendant Bay repeats the allegations of paragraphs 22 through 36 inclusive, of its First Affirmative Defense as though set forth at length at this point and incorporates them herein by reference.

58. Defendant Bay is informed and believes and relying upon such information and belief alleges that the true and beneficial owner of Plaintiff corporation is one, Davis; that said Davis is also the true and beneficial owner of a 36 per cent interest in Defendant Bay. Because of the interest of said Davis on both sides of this proceeding, the Complaint fails to state a cause of action.

For a Further, Separate, and Ninth Affirmative Defense to Count One of Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

59. It appears on the face of the Complaint that Plaintiff's Count One is a personal action by a shareholder (Plaintiff Robbins) of a corporation, (Defendant Pacific) to recover damages and other relief for an alleged injury to the corporation. The allegations of said Count One fail to disclose any

injury to Plaintiff's shareholders as such. Said Count One fails to state a cause of action because it should properly have been brought, if at all, in the form of a derivative shareholders suit.

For a Further, Separate, and Tenth Affirmative Defense of Count Two of Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

60. It appears on the face of the Complaint on file herein that Plaintiff's Count Two is a derivative suit by a shareholder (Plaintiff Robbins) for an alleged injury to a corporation (Defendant Pacific). Plaintiff Robbins fails to allege that it made any demand upon the Board of Directors of Defendant Pacific to institute an action based on the facts alleged in said Count Two, or that it made any efforts whatsoever to secure from said Board the relief it desires, or that it has ever informed Defendant Pacific or its said Board of Directors in writing of its claim against Defendant Pacific or its Directors, or that it has ever exhibited a true copy of a proposed Complaint to Defendant Pacific or its Directors before the filing of this action; and Plaintiff Robbins has further failed to allege any sufficient or adequate reason which would excuse Plaintiff Robbins from making such demand or taking such action before the filing of this suit.

For a Further, Separate, and Eleventh Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

61. Defendant Bay alleges that Plaintiff Robbins

has improperly joined a cause of action for damage to a shareholder of a corporation in its personal capacity with a cause of action in the form of a derivative shareholders' suit for injury to the corporation as such.

For a Further, Separate, and Twelfth Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

62. Defendant Bay is informed and believes and relying upon such information and belief alleges that the two agreements described in paragraph 9 of Plaintiff's Complaint on file herein, and for the transfer of which Plaintiff Robbins seeks relief, are in fact three agreements which are described in paragraph 6 of this Answer.

63. Defendant Bay alleges that said agreements consisted of three (3) agreements, one dated August 28, 1950 between RFC on the one hand and Pacific and Minnesota Mining & Manufacturing Company on the other hand, providing for the operation by Minnesota Mining & Manufacturing Company of a synthetic rubber plant owned by RFC and located at Torrance, California, which aid agreement was dated August 28, 1950, and has hereinabove been referred to as the "RFC-Pacific Agreement", a second agreement dated September 0, 1950, between Minnesota Mining & Manufacturing Company and Defendant Pacific, which provided for the operation of said synthetic rubber plant, the division of the management fee received from RFC therefor, the performance of certain ob-

ligations by Defendant Pacific, and the assumption by Defendant Pacific of 35 per cent of any liability incurred by Minnesota Mining & Manufacturing Company for injury to or death of persons or damage to property arising out of or connected with performance of said RFC-Pacific Agreement, for which Minnesota Mining & Manufacturing Company would not be reimbursed by RFC, which said agreement was dated September 20, 1950, and has hereinabove been referred to as "M-P Agreement", and a third agreement between Minnesota Mining & Manufacturing Company and Defendant Pacific, setting forth the respective rights and duties of Minnesota Mining & Manufacturing Company and Defendant Pacific with regard to inventions and patent rights, which said agreement was dated September 20, 1950, and has hereinabove been referred to as "Patent Agreement". Subsequent to the making of such agreements the interests of Minnesota Mining & Manufacturing Company therein was assigned in writing to Midland Rubber Company, a corporation, which has hereinabove been referred to as "Midland", and Midland assumed all of the rights and duties of said Minnesota Mining & Manufacturing Company under said contracts, with the approval and consent of RFC.

64. On or about June 29, 1951, said M-P Agreement and Patent Agreement were cancelled and terminated and new agreements between Midland and Defendant Bay were substituted therefor. By cancelling said M-P Agreement and Patent Agreement, Midland gave up substantial rights against

Defendant Pacific and against Defendant Bay as the successor-in-interest to Defendant Pacific. Midland will be substantially prejudiced if the relief sought in the Complaint on file herein were granted, and for that reason should be a party to both causes of action stated in said Complaint. There is a defect of parties to this action in that Midland is neither a party Plaintiff nor a party Defendant and said Midland is a necessary and indispensable party to a complete determination of the action.

For a Further, Separate, and Thirteenth Affirmative Defense to Plaintiff's Complaint on File Herein, Defendant Bay Avers as Follows:

65. Defendant Bay alleges that Plaintiff's Complaint as a whole, and each of the Counts contained herein, fail to state facts sufficient to constitute a cause of action against Defendant Bay.

Wherefore, Defendant Bay prays that Plaintiff take nothing by reason of its complaint on file herein, that the same be hence dismissed, that Defendant Bay be awarded its costs of suit herein incurred and that this honorable Court grant Defendant Bay such other and further relief as it may deem just and proper.

Dated: January 31, 1955.

/s/ ORRIS R. HEDGES,  
/s/ LLOYD W. DINKELSPIEL,  
/s/ EDWARD W. ROSSTON,  
HELLER, EHRMAN, WHITE &  
McAULIFFE,  
Attorneys for Defendants.

**EXHIBIT "A"**  
**AGREEMENT**

This Agreement made this 7th day of January, 1951, by and between Inland Rubber Corporation, an Ohio Corporation with its principal office at Mansfield, Ohio (hereinafter called "Inland") and Edwin W. Pauley individually at 717 North Highland Avenue, Los Angeles 38, California (hereinafter called "Pauley"), William R. Pagen, Trustee, (hereinafter called "Trustee") and Poncet Davis of The Mayflower Hotel, Akron, Ohio, Trustee for Poncet Davis Jr. and Katharine "Trinka" Davis, (hereinafter called "Davis").

Witnesseth: That

Whereas, John B. Condrey and Robbins Tire and Rubber Company, the holders of all of the stock of Pacific Rubber Company, desire to liquidate said corporation and sell the assets thereof; and

Whereas, the parties hereto are willing to form a corporation to purchase certain assets of Pacific Rubber Company;

Now therefore, it is hereby agreed as follows:

(1) The parties hereto will contemporaneously with the execution of this agreement enter into an agreement with Condrey and Robbins in the form attached hereto marked "Exhibit A".

(2) The corporation to be formed by the parties hereto pursuant to said agreement shall be formed subject to the following:

(a) Its primary purpose shall be to engage in

the manufacture and sale of tires, tubes, and other rubber products.

(b) It shall have an initial paid in capitalization of \$300,000.00, \$100,000.00 in common voting stock, and \$200,000.00 in four percent (4%) debenture notes payable within ten years. Interest on said debenture notes shall be paid annually. The parties hereto agree to subordinate the principal and interest on their debenture notes to any obligations which the corporation may incur with any loaning agency or creditor. Inland will take one-half of the stock and one-half of the debenture notes, and the Limited Co-partnership referred to in sub-paragraph (c) hereof will take the other half of the stock and notes.

(c) Pauley, Trustee, and Davis will forthwith form a Limited Co-partnership to be known as Bay Rubber Company. Pauley will be the general partner, and Trustee (or his nominee or nominees) and Davis will be the limited partners. Their interests in said partnership shall be as follows:

Edwin W. Pauley	51%
William R. Pagen, Trustee	14%
Poncet Davis, Trustee	35%

(d) The Corporation's articles shall provide pre-emptory rights to purchase stock proportionate to stock holdings.

(e) The Corporation will be a so-called closed corporation so that neither stockholder, Inland or Bay Rubber Company may, without the consent

of the other sell, pledge or otherwise dispose of the stock held by it (other than by way of dividend or distribution in liquidation, merger or consolidation, in which event the transferee will take said stock subject to the same restrictions) without first offering all of it to the other at a price per share to be set by the offeror at the time the offer is made. Within thirty (30) days after such an offer is made, the offeree must either (1) accept the offer and agree to pay for the stock offered within the next ninety (90) days, or (2) sell all of its stock to the offeror, who must buy it at the same price and pay for same within the next ninety (90) days.

(3) On and after July 1, 1955, either stockholder, Inland or Bay Rubber Company, may force the other either to sell its stock to such moving party or to buy the stock of such moving party. This may be done by one party offering in writing to buy the other's stock at a price per share set by the offeror in such offer. In the event of such an offer the offeree shall, within sixty (60) days after the making of the offer, either (1) agree to sell his stock to the offeror at the price stated in the offer, in which case the offeror shall pay for the same within the next thirty (30) days, or (2) agree to buy the offeror's stock at said price and pay for the same within the next ninety (90) days. An appropriate reference to this agreement shall be made on the stock certificates of the corporation at the time of issuance.

(4) This agreement shall be binding upon and

inure to the benefit of the parties, their executors, administrators, heirs, successors, and assigns.

In witness whereof, said Inland Rubber Corporation has caused its corporate name to be subscribed by its duly authorized officer and said Edwin W. Pauley individually, William R. Pagen, Trustee, and Poncet Davis, Trustee, have each subscribed his name to triplicate copies hereof on the date first above written.

/s/ Edwin W. Pauley

/s/ William R. Pagen,  
Trustee.

/s/ Poncet Davis,  
Trustee.

Inland Rubber Corporation,

/s/ By Ezra K. Bryan,  
President.

Witnesseth:

/s/ Orris R. Hedges

/s/ George Bouchard

**EXHIBIT "B"**

**AGREEMENT**

This Agreement, made this 7th day of January, 1951, by and between Edwin W. Pauley of 717 North Highland Avenue, Los Angeles 38, California, Poncet Davis of the Mayflower Hotel, Akron, Ohio, Trustee for Poncet Davis Jr. and Katharine "Trinka" Davis, and Inland Rubber Corporation, an Ohio Corporation with its principal office at Mansfield, Ohio, Parties of the First Part (hereinafter called "Incorporators") and John B. Con-

drey of 4901 East Twelfth Street, Oakland, California, and Robbins Tire and Rubber Company, an Alabama Corporation with its principal office at Tuscumbia, Alabama, Parties of the Second Part (hereinafter called "Sellers").

Witnesseth: That

Whereas, the Incorporators are willing to form a corporation (hereinafter called the "Corporation") to purchase certain assets of Pacific Rubber Company, a California Corporation with its principal office at Oakland, California, (hereinafter called "Pacific") and,

Whereas, the Sellers are the owners of all of the issued and outstanding stock of Pacific, and the Sellers desire to liquidate Pacific and to sell its assets;

Now therefore, it is agreed as follows:

1. The Incorporators shall on or before January 15, 1951, (hereinafter referred to as the "Closing Date") incorporate the Corporation under the laws of the State of California with an initial capitalization of not less than Three Hundred Thousand Dollars (\$300,000.00) which may be in both stock and four per cent (4%) debenture notes and which shall actually be paid in by the Incorporators on or before the Closing Date.

2. Prior to the Closing Date the Sellers shall obtain from Pacific and deliver to the Incorporators such consent or other document as shall be necessary to permit the incorporation of the Corpo-

ration with the name of Pacific Tire and Rubber Company.

3. On the Closing Date (as of the opening of business) Sellers shall sell, transfer, and deliver to the Corporation the property hereinafter described and prior to that date shall take such steps with reference to liquidating Pacific as are necessary.

4. Prior to Closing Date Sellers shall cause Pacific to exercise the option to purchase contained in the lease agreement dated January 1, 1949, between the Reconstruction Finance Corporation and Pacific as amended on the most advantageous terms available as to deferment of payment and interest rate. The obtaining of this property is of the essence of this agreement and the Incorporators and the Corporation shall have the right to terminate this agreement if Sellers fail to obtain it.

5. On the Closing Date Sellers shall:

(a) Transfer by Grant Deed and Bill of Sale to the Corporation all of Pacific's present land, buildings, machinery and equipment (hereinafter referred to as "Fixed Assets"). It is agreed that said Fixed Assets include the land and buildings of Pacific's plant at 4901 East Twelfth Street, Oakland, California, and all of the machinery and equipment therein including that which is covered by the Reconstruction Finance Corporation lease referred to in Paragraph 4 above.

(b) Transfer by Bill of Sale to the Corporation all of Pacific's raw materials, work in process, fin-

ished goods and supplies on hand on the Closing Date.

(c) Assign to the Corporation all of Pacific's contracts and agreements which are listed and described in a schedule to be accepted by both parties and attached to this agreement as soon as possible; except, however, that the Minnesota Mining & Manufacturing Company - Pacific agreement and the Reconstruction Finance Corporation-Pacific agreement are not to be assigned to the Corporation. As to those contracts and agreements which require consent in order to be assigned, Sellers will secure such consent.

(d) Assign to the Corporation all of Pacific's present right, title, and interest in and to any copyrights, trademarks, brand names, patents, and patent applications and the like.

6. The Corporation shall pay Sellers for the items described in paragraph 5 above as follows:

[Marginal note: Modified. See letter dated January 26, 1951.]

(a) For said Fixed Assets the Corporation shall on the Closing Date pay to Sellers Two Hundred Fifty Thousand Dollars (\$250,000.00) and deliver to Sellers promissory notes aggregating Seven Hundred Fifty Thousand Dollars (\$750,000.00) and a deed of trust and chattel mortgage securing said notes and covering all of said Fixed Assets. Said notes shall bear interest at the rate of four per cent (4%) per annum. On the first of each month be-

ginning with March 1, 1951, the Corporation shall pay on said notes an amount equal to one-half of the Corporation's net profit after taxes for the monthly period from the 15th day of the second month preceding to the 15th day of the month preceding the day of payment; provided, however, that cumulatively said amounts so paid shall in no event be less than the amounts provided in the following schedule:

1. \$75,000.00 on or before July 1, 1951.
2. \$75,000.00 on or before January 2, 1952.
3. \$75,000.00 on or before April 1, 1952.
4. \$75,000.00 on or before July 1, 1952.
5. \$75,000.00 on or before January 2, 1953.
6. \$75,000.00 on or before July 1, 1953.
7. \$75,000.00 on or before January 2, 1954.
8. \$75,000.00 on or before July 1, 1954.
9. \$75,000.00 on or before January 2, 1955.
10. \$75,000.00 on or before July 1, 1955.

Said Chattel Mortgage shall provide that the Corporation may at any time dispose of any of the property covered by the mortgage provided it either (1) replaces the same at its own expense with property of similar or greater value and gives the Sellers a chattel mortgage on such replacement property, or (2) sells the same at its fair market value and turns the proceeds over to the Sellers in reduction of the last payment on said notes.

(b) As further consideration for said Fixed Assets the Corporation shall on the Closing Date pay to the Sellers the amount of any sums paid by Pacific on account of the purchase price for the assets

covered by the Reconstruction Finance Corporation lease described in paragraph 4 above. The Corporation shall assume and agree to pay the balance of the said purchase price.

(c) For said raw materials, work in process and supplies the Corporation shall pay the Sellers an amount equal to market value on the Closing Date, except in the case of crude rubber and any type of item involving less than \$10,000.00 the Corporation shall pay Pacific's book value. For said finished goods the Corporation shall pay the Sellers an amount equal to Pacific's book value plus ten per cent (10%). The amount due for finished goods and supplies shall be paid on or before April 15, 1951. The amount due for raw materials and work in process shall be paid on or before May 15, 1951. On or before the Closing Date the parties hereto will jointly make or cause to be made a physical inventory of said raw materials, work in process, finished goods and supplies.

(d) As to said contracts and agreements being assigned to the Corporation hereunder, the Corporation shall assume the obligations of Pacific thereunder except for obligations applicable to the period prior to the Closing Date.

(e) For said copyrights, trademarks, brand names, patents and patent applications and the like, the Corporation shall pay the Sellers One Thousand Dollars (\$1,000.00) on the Closing Date.

7. Sellers agree that at the time of transfer to the Corporation all of the property which is being

sold to the Corporation hereunder will be free and clear of all liens and encumbrances except:

(a) Current accrued and unpaid property taxes which shall be prorated between the Sellers and the Corporation as of the Closing Date,

(b) Easements, restrictions and rights-of-way of record as to the real property and,

(c) Any lien for unpaid purchase price applicable to the property Pacific is to acquire as provided in paragraph 4 above.

8. Sellers agree to have the plant and business of Pacific operated and conducted normally until the Closing Date. Thereafter, the Corporation shall, until full performance by it of its obligations hereunder, so operate and conduct said plant and business subject, however, to such restrictions as may be imposed by Governmental authority.

9. The Corporation shall perform for the account of the Sellers all outstanding tire and tube warranties of Pacific. The Corporation shall use its best efforts to collect Pacific's accounts receivable and shall turn over to the Sellers all proceeds of such collections less only out of pocket expenses. The Corporation shall not place said accounts receivable with an attorney or a collection agency for collection.

10. As promptly as reasonably possible, but in any event before the Closing Date, Sellers shall deliver to the Incorporators a certified copy of a resolution of the Board of Directors of Robbins

Tire and Rubber Company authorizing this agreement.

11. On the Closing Date the Corporation shall accept this agreement and deliver to Sellers a certified copy of the resolution of its Board of Directors, authorizing this agreement. Thereupon the corporation shall become and be a party to this agreement.

12. The Corporation shall indemnify and hold Sellers and Pacific harmless from all liabilities arising from obligations assumed hereunder by the Corporation.

13. In the event of the default of the Corporation in the performance of any of its obligations under paragraphs 6(a), 6(b), 6(c), 8 and 12 hereof, all obligations of the Corporation hereunder shall at Sellers' option become forthwith due and payable unless the Corporation shall have cured such defaults (as are curable) within ten (10) days after written notice of default to the Corporation and Incorporators. In the event aforesaid, Sellers shall have power in addition to other remedies provided by law, to take possession of said plant and assets and operate the same. The Sellers in such event shall also have power to take possession of any or all raw materials, work in process, finished goods and supplies. In the event of such a repossession the value of the raw materials, work in process, finished goods and supplies repossessed shall be fixed by the market value thereof on the date of repossession. Sellers shall also have power to repossess and retake

title to all copyrights and other assets described in paragraph 5 (d) hereof.

14. The Corporation shall pay Sellers, as part of the purchase price hereof, any and all applicable sales, use or excise taxes imposed by any Governmental authority.

15. This contract shall be interpreted under the laws of the State of California.

16. Until otherwise advised in writing, notices shall be directed to the following addresses by registered mail.

Edwin W. Pauley, 717 North Highland Avenue, Los Angeles 38, California.

Poncet Davis, Mayflower Hotel, Akron, Ohio.

Inland Rubber Corporation, Mansfield, Ohio.

John B. Condrey, 4901 East 12th Street, Oakland, California.

Robbins Tire and Rubber Company, Tuscumbia, Alabama.

Pacific Tire and Rubber Company (The Corporation), 4901 East 12th Street, Oakland, California.

Such notices shall be deemed to be given upon mailing.

17. This agreement shall be binding upon and inure to the benefit of the parties, their executors, administrators, heirs, successors and assigns.

18. If in connection with the closing it becomes necessary to escrow any money or papers, then the American Trust Company of San Francisco shall be escrow agent.

In Witness Whereof, the individuals who are parties have subscribed their names and the corporations who are parties have caused their names to be subscribed by their duly authorized officers to six counterparts hereof on the day first above written.

/s/ Edwin W. Pauley

/s/ Poncet Davis

Witnesseth:

/s/ Orris R. Hedges

/s/ George Bouchard

Inland Rubber Corporation

/s/ By Ezra K. Bryan,  
President

/s/ John B. Condrey

Witnesseth:

/s/ Georgia Stanley

Robbins Tire and Rubber Co., Inc.

/s/ By Poncet Davis,  
President

Accepted this fifteenth day of January, 1951,  
Pacific Tire and Rubber Com-  
pany

/s/ By E. W. Booz,  
Vice President

/s/ By John B. Condrey,  
Secretary

[Endorsed]: Filed Jan. 31, 1955.

[Title of District Court and Cause.]

**ANSWER OF DEFENDANTS EDWIN W.  
PAULEY AND C. L. CAMERON**

Come now the Defendants Edwin W. Pauley and C. L. Cameron, and severing from their Co-Defendants and answering each for themselves alone, for answer to Plaintiff's Complaint on file herein, admit, deny and aver as follows:

**For Answer to Count One**

1. Answering Defendants hereby adopt and make part of their answer to the Complaint on file herein all of the allegations of Bay Rubber Company, a Limited Partnership, Co-Defendant in the above-entitled action as set forth in paragraphs, 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 12 and 13 of the answer of said Defendant Bay.

2. In answer to paragraph 8 of Plaintiff's Complaint, answering Defendants admit that on or about January 5, 1951, the owners of all of the issued and outstanding shares of stock of Defendant Pacific (including Plaintiff herein) at a special stockholders meeting duly called upon notice and held for that purpose, voted to wind up and dissolve the Defendant Pacific and authorized and directed the officers and directors of said Company to take such action as might be necessary and proper to wind up the affairs and dissolve the Company. Answering Defendants allege that they were informed of said resolution adopted by the Shareholders of Defend-

ant Pacific on or about January 5, 1951, but deny that said resolution provided for the transfer of all of the Defendant Pacific's assets to its stockholders, or that said shareholders of Defendant Pacific on said date, or at any other time, adopted any resolution of the character alleged in said paragraph 8; that they lack information or belief sufficient to answer the remaining allegations of said paragraph 8, and basing their denial on that ground deny generally and specifically, each and every, all and sundry said allegations.

Wherefore, these answering Defendants pray that Plaintiff take nothing by reason of Count One of its Complaint on file herein and that the same be dismissed and that answering Defendants be awarded their costs of suit and such other and further relief as to the Court may seem just and proper.

#### For Answer to Count Two

3. Answering Defendants hereby adopt and make part of their answer to Count Two of Plaintiff's Complaint all of the allegations of Bay Rubber Company, Co-Defendant in the above-entitled action as set forth in paragraphs 14 (except that paragraph 2 of this answer is substituted for paragraph 5 of the answer of Defendant Bay) and further adopt and make a part of this answer the allegations of paragraphs 15, 16, 17, 18, 19, 20 and 21 of the answer of the said Defendant Bay.

Wherefore, answering Defendants pray that Plaintiff take nothing by reason of Count Two of

its Complaint on file herein, that the same be dismissed and answering Defendants be awarded their costs of suit and such other and further relief as to the Court may seem just and proper.

For a further, separate, and affirmative defense to Plaintiff's Complaint on file herein, answering Defendants aver as follows:

4. Answering Defendants hereby adopt and make part of their Affirmative Defense to Plaintiff's Complaint on file herein all of the allegations of Bay Rubber Company, Co-Defendant in the above-entitled action, as set forth in its Further, Separate and First to Thirteenth (inclusive) Affirmative Defenses to Plaintiff's Complaint, with the exception of paragraphs 39, 44 and 51 thereof.

5. In lieu of paragraph 39 of Defendant Bay's answer, these answering Defendants allege that at no time mentioned in Plaintiff's Complaint did answering Defendants, or either of them, conspire with Defendants Bay, Condrey or DeSellem, or any of them, or each other, or with any other person, firm or corporation, to transfer the assets of the Defendant Pacific described in paragraph 9 of Plaintiff's Complaint, or any other assets of Defendant Pacific to Defendant Bay, to the damage of Plaintiff, or any other person.

6. In lieu of paragraph 44 of Defendant Bay's answer these answering Defendants allege that in reliance upon the transfer of said agreements by Defendant Pacific to Defendant Bay and because

of the failure of Plaintiff Robbins, or its sole and beneficial owner, Davis, to make any objections to said transfer, on or about the 29th day of June, 1951, Defendant Pauley, as a General Partner in Defendant Bay, and Defendant Cameron, as a Limited Partner in Defendant Bay, participated in and authorized the cancellation and termination of the said M-P Agreement and Patent Agreement between Defendant Pacific and Midland and in the substitution therefor of new agreements between Midland and Defendant Bay, which agreements ever since that date have been and now are in effect. Ever since said date, Defendant Bay has been and now is performing its obligations under said new agreements and has participated in the RFC-Pacific Agreement with Midland, and Defendant Pauley, as a General Partner in Defendant Bay, and Defendant Cameron, as a Limited Partner in Defendant Bay prior to December 28, 1951, and as a General Partner in Defendant Bay after said date, have acted in reliance upon said new agreements and said transfer and assignment to Defendant Bay of Pacific's interest under said cancelled agreements, and have authorized distributions to the partners of Defendant Bay (including the said Davis) from funds paid to Defendant Bay by Midland as Bay's share of the management fee under said agreements. In this respect Defendant Pauley also alleges that in reliance upon the substitution of Defendant Bay for Defendant Pacific under said M-P Agreement and Patent Agreement and in reliance upon the assignment and transfer to Defendant Bay of Pa-

cific's entire interest in RFC-Pacific Agreement, M-P Agreement and Patent Agreement, he did, on or about June 29, 1951, give his personal written guarantee to Midland that Defendant Bay would perform all of its obligations under said agreements.

7. In lieu of paragraph 51 of Defendant Bay's answer these answering Defendants allege that if they, or either of them, are now required to account for the proceeds of the transfer of said agreements, or to respond to Plaintiff in damages, they and each of them will be gravely prejudiced in that in reliance upon said transfer, ever since May 21, 1951, the date on which such transfer was made, Defendant Pauley, as a General Partner in Defendant Bay, and Defendant Cameron, as a Limited Partner in Defendant Bay prior to December 28, 1951, and as a General Partner in Defendant Bay after said date, have participated in and authorized performance of duties and the fulfillment of obligations by Defendant Bay under said M-P Agreement and Patent Agreement and under the two new agreements with Midland substituted therefor and referred to in paragraph 6 of this answer; and have further participated in and authorized the distribution by Defendant Bay of funds paid to Defendant Bay by Midland as Bay's share of the management fee under said Agreements to the Partners in Defendant Bay, (including the said Davis). In reliance upon the validity of said transfer; and in this respect, Defendant Pauley alleges that he has been further prejudiced in that on or about June 29,

1951, he gave his written guarantee to Midland that Defendant Bay would perform all of the obligations assumed by it under said agreements.

Wherefore, Defendants Pauley and Cameron pray that Plaintiff take nothing by reason of its Complaint on file herein, that the same be hence dismissed, that answering Defendants be awarded their costs of suit herein incurred and that this honorable Court grant answering Defendants such other and further relief as it may deem just and proper.

Dated: January 31, 1955.

/s/ ORRIS R. HEDGES,  
/s/ LLOYD W. DINKELSPIEL,  
/s/ EDWARD W. ROSSTON,  
HELLER, EHRMAN, WHITE  
& McAULIFFE,  
Attorneys for Defendants

[Endorsed]: Filed Jan. 31, 1955.

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[Title of District Court and Cause.]

#### ANSWER OF DEFENDANT PACIFIC RUBBER COMPANY

Comes now the Defendant Pacific Rubber Company, and severing from its Co-Defendants and answering for its self alone, for answer to Plaintiff's Complaint on file herein, admits, denies and avers as follows:

For Answer to Count One

1. Answering Defendant hereby adopts and makes part of its answer to the Complaint on file

herein all of the allegations of Bay Rubber Company, a Limited Partnership, Co-Defendant in the above-entitled action as set forth in paragraphs 1, 2, 3, 4, 6, 7, 8, 10, 11, 12 and 13 of the answer of the said Defendant Bay Rubber Company.

2. In answer to paragraph 8 of Plaintiff's Complaint, Answering Defendant admits that on or about January 5, 1951, the owners of all of the issued and outstanding shares of stock of Defendant Pacific Rubber Company (including Plaintiff herein) at a special stockholders' meeting duly called upon notice and held for that purpose, voted to wind up and dissolve the Defendant Pacific Rubber Company and authorized and directed the officers and directors of said Company to take such action as might be necessary and proper to wind up the affairs and dissolve the Company. Answering Defendant alleges that Defendants Pauley, Cameron, DeSellem and Condrey were informed of said resolution adopted by the shareholders of Defendant Pacific Rubber Company on or about January 5, 1951, but deny that said resolution provided for the transfer of all of the Defendant Pacific's assets to its stockholders or that said shareholders of Pacific on said date or at any other time adopted any resolution of the character alleged in said paragraph 8.

3. In lieu of paragraph 9 of Defendant Bay's answer, Defendant Pacific avers that it is informed and believes that the allegations and denials of said paragraph 9 are true and relying upon such infor-

mation and belief incorporates them herein by reference.

Wherefore this answering Defendant prays that Plaintiff take nothing by reason of Count One of its Complaint on file herein and that the same be dismissed and that answering Defendant be awarded its costs of suit and such other and further relief as to the Court may seem just and proper.

For Answer to Count Two

4. Answering Defendant hereby adopts and makes part of its answer to Count Two of Plaintiff's Complaint all of the allegations of Bay Rubber Company, Co-Defendant in the above-entitled action as set forth in paragraphs 14 (except that paragraphs 2 and 3 of this answer are substituted for paragraphs 5 and 8 of the answer of Defendant Bay), and further adopts and makes part of this answer the allegations of paragraphs 15, 16, 17, 18, 19, 20 and 21 of the answer of the Defendant Bay, except that Defendant Pacific alleges of its own knowledge those facts alleged on information and belief in paragraph 20 of Defendant Bay's answer.

Wherefore, answering Defendant prays that Plaintiff take nothing by reason of Count Two of its Complaint on file herein, that the same be dismissed and answering Defendant be awarded its costs of suit and such other and further relief as to the Court may seem just and proper.

For a further, separate, and First Affirmative Defense to Plaintiff's Complaint on file herein, answering Defendants aver as follows:

5. Answering Defendant hereby adopts and makes part of its Affirmative Defense to Plaintiff's Complaint on file herein all of the allegations of Bay Rubber Company, Co-Defendant in the above-entitled action, as set forth in its Further, Separate and First to Thirteenth (inclusive) Affirmative Defenses to Plaintiff's Complaint, except paragraph 35, 44 and 51 thereof, and except that Defendant Pacific alleges of its own knowledge those facts alleged on information and belief in paragraphs 28 and 29 of Defendant Bay's answer.

6. Defendant Pacific alleges that it is informed and believes that the facts alleged in paragraph 35 of Defendant Bay's answer are true, and relying upon such information and belief incorporates the allegations of said paragraph 35 herein by reference.

7. In lieu of paragraph 44 of Defendant Bay's answer Defendant Pacific alleges that in reliance upon the failure of Plaintiff Robbins, and its sole and beneficial owner, Davis, to make any objection either to the proposed transfer of the said RFC-Pacific Agreement, M-P Agreement or Patent Agreement by Defendant Pacific to Defendant Bay or to the actual transfer of said agreements until approximately two months prior to the filing of this action, Defendant Pacific transferred its right under said agreements to Defendant Bay, receiving a valuable consideration for such transfer and made no objection to the subsequent cancellation by Defendant Bay and Midland of said M-P Agreement

and said Patent Agreement and the substitution of Defendant Bay for Defendant Pacific as the beneficiary of the agreement to share the management fee for operation of the Synthetic Rubber Plant covered by the said RFC-Pacific Agreement, to its detriment.

8. In lieu of paragraph 51 of Defendant Bay's answer Defendant Pacific alleges that in reliance upon the failure of Plaintiff Robbins, and its sole and beneficial owner, Davis, to make any objection either to the proposed transfer of the said RFC-Pacific Agreement, M-P Agreement or Patent Agreement by Defendant Pacific to Defendant Bay or to the actual transfer of said agreements until approximately two months prior to the filing of this action, Defendant Pacific transferred its right under said agreements to Defendant Bay, receiving a valuable consideration for such transfer and made no objection to the subsequent cancellation by Defendant Bay and Midland of said M-P Agreement and said Patent Agreement and the substitution of Defendant Bay for Defendant Pacific as the beneficiary of the agreement to share the management fee for operation of the Synthetic Rubber Plant covered by the said RFC-Pacific Agreement, to its detriment.

Wherefore, Defendant Pacific Rubber Company prays that Plaintiff take nothing by reason of its Complaint on file herein, that the same be hence dismissed, that answering Defendant be awarded its costs of suit herein incurred and that this honorable

Court grant answering Defendant such other and further relief as it may deem just and proper.

Dated: January 31, 1955.

/s/ ORRIS R. HEDGES,  
/s/ LLOYD W. DINKELSPIEL,  
/s/ EDWARD W. ROSSTON,  
HELLER, EHRMAN, WHITE  
& McAULIFFE,  
Attorneys for Defendants

[Endorsed]: Filed Jan. 31, 1955.

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[Title of District Court and Cause.]

ANSWER OF DEFENDANTS WESLEY H.  
DeSELLEM AND JOHN B. CONDREY

Come now the Defendants Wesley H. DeSellem and John B. Condrey, and severing from their Co-Defendants and answering each for themselves alone, for answer to Plaintiff's Complaint on file herein, admit, deny and aver as follows:

For Answer to Count One

1. Answering Defendants hereby adopt and make part of their answer to the Complaint on file herein all of the allegations of Bay Rubber Company, a Limited Partnership, Co-Defendant in the above-entitled action as set forth in paragraphs 1, 3, 4, 6, 7, 8, 10, 11, 12 and 13 of the answer of the said Defendant Bay Rubber Company.
2. Answering Defendants admit the allegations of paragraph 4 of Plaintiff's Complaint.

3. In answer to paragraph 8 of Plaintiff's Complaint, answering Defendants admit that on or about January 5, 1951, the owners of all of the issued and outstanding shares of stock of Defendant Pacific (including Plaintiff herein) at a special stockholders meeting duly called upon notice and held for that purpose, voted to wind up and dissolve the Defendant Pacific and authorized and directed the officers and directors of said Company to take such action as might be necessary and proper to wind up the affairs and dissolve the Company. Answering Defendants allege that they were informed of said resolution adopted by the Shareholders of Defendant Pacific on or about January 5, 1951, but deny that said resolution provided for the transfer of all of Defendant Pacific's assets to its stockholders, or that said Shareholders of Defendant Pacific on said date, or at any other time, adopted any resolution of the character alleged in said paragraph 8; that they lack information and belief sufficient to answer the remaining allegations of said paragraph 8, and basing their denial upon that ground, deny generally and specifically, each and every, all and sundry, the remaining allegations thereof.

4. In answer to paragraph 12 of Plaintiff's Complaint Defendant Condrey adopts and makes part of his answer to the Complaint on file herein all of the allegations of Defendant Bay as set forth in paragraph 9 of Defendant Bay's answer; and Defendant DeSellem alleges that he lacks information

or belief sufficient to answer the allegations of paragraph 12 of said Complaint, and basing his denial on that ground denies, generally and specifically, each and every, all and sundry, the allegations thereof.

Wherefore, these answering Defendants pray that Plaintiff take nothing by reason of Count One of its Complaint on file herein and that the same be dismissed and that answering Defendants be awarded their costs of suit and such other and further relief as to the Court seems just and proper.

For Answer to Count Two

5. Answering Defendants hereby adopt and make part of their answer to Count Two of Plaintiff's Complaint all of the allegations of Bay Rubber Company, Co-Defendant in the above-entitled action as set forth in paragraph 14 (except that paragraphs 2, 3 and 4 of this answer are substituted for paragraphs 2, 5 and 9 respectively, of the answer of Defendant Bay), and further adopt and make a part of this answer the allegations of paragraphs 15, 16, 17, 18, 19, 20 and 21 of the answer of the said Defendant Bay, except that answering Defendants have knowledge of the matters covered by paragraph 20 of Defendant Bay's answer, and make all of the allegations and denials of said paragraph 20 as of their own knowledge.

Wherefore, answering Defendants pray that Plaintiff take nothing by reason of Count Two of its Complaint on file herein, that the same be dismissed and answering Defendants be awarded their

costs of suit and such other and further relief as to the Court may seem just and proper.

For a further, separate, and Affirmative Defense to Plaintiff's Complaint on file herein, answering Defendants aver as follows:

6. Answering Defendants hereby adopt and make part of their Affirmative Defense to Plaintiff's Complaint on file herein all of the allegations of Bay Rubber Company, Co-Defendant in the above-entitled action, as set forth in its Further, Separate and First to Thirteenth (inclusive) Affirmative Defenses to Plaintiff's Complaint, except paragraphs 39, 44 and 51 thereof, and with the further exceptions that answering Defendants have knowledge of the matters covered by paragraphs 28 and 29 of Defendant Bay's answer and make all of the allegations thereof as of their own knowledge; and that Defendant DeSellem lacks knowledge of the matters covered by paragraphs 35 and 36 of Defendant Bay's answer, but has been informed of said matters and believes the truth of said information, and accordingly makes the allegations contained in said paragraphs 35 and 36 on such information and belief.

7. In lieu of paragraph 39 of Defendant Bay's answer, these answering Defendants allege that at no time mentioned in Plaintiff's Complaint did answering Defendants, or either of them, conspire with Defendants Bay, Pauley or Cameron, or any of them, or each other, or with any other person, firm or corporation, to transfer the assets of the

Defendant Pacific described in paragraph 9 of Plaintiff's Complaint, or any other assets of Defendant Pacific to Defendant Bay, to the damage of Plaintiff, or any other person.

8. In lieu of paragraph 44 of Defendant Bay's answer these answering Defendants allege that in reliance upon the transfer of said agreements by Defendant Pacific to Defendant Bay and because of the failure of Plaintiff Robbins, or its sole and beneficial owner, Davis, to make any objections to said transfer, on or about the 29th day of June, 1951, Defendant Condrey, as a Limited Partner in Defendant Bay, participated in and authorized the cancellation and termination of the said M-P Agreement and Patent Agreement between Defendant Pacific and Midland and in the substitution therefor of new agreements between Midland and Defendant Bay, which agreements ever since that date have been and now are in effect. Ever since said date, Defendant Bay has been and now is performing its obligations under said new agreements and has participated in the RFC-Pacific Agreement with Midland, and Defendant Condrey, as a Limited Partner in Defendant Bay, has acted in reliance upon said new agreements and said transfer and assignment to Defendant Bay of Pacific's interest under said cancelled agreements, and has authorized distribution to the partners of Defendant Bay (including the said Davis) from funds paid to Defendant Bay by Midland as Bay's share of the management fee under said agreements, to his detriment.

9. In lieu of paragraph 51 of Defendant Bay's answer these answering Defendants allege that if they, or either of them, are now required to account for the interest of Defendant Pacific in said agreements which has been so transferred to Defendant Bay, or for the proceeds of the transfer of said agreements, or to respond to Plaintiff in damages, they and each of them will be gravely prejudiced, in that in reliance upon an authorization from the Board of Directors of Defendant Pacific, they caused Defendant Pacific to make such transfer to Defendant Bay; and at divers times since May 21, 1951, the date on which such transfer was made, Defendant Condrey, as a Limited Partner in Defendant Bay, has participated in and authorized performance of duties and the fulfillment of obligations by Defendant Bay under said M-P Agreement and Patent Agreement and under the two new agreements with Midland substituted therefor (referred to in paragraph 8 of this answer); and has further participated in and authorized the distribution by Defendant Bay of funds paid to Defendant Bay by Midland as Bay's share of the management fee under said Agreements to the Partners in Defendant Bay, (including the said Davis), to his detriment.

Wherefore, Defendants Condrey and DeSellem pray that Plaintiff take nothing by reason of its Complaint on file herein, that the same be hence dismissed, that Defendants Condrey and DeSellem be awarded their costs of suit herein incurred and that this honorable Court grant answering Defendants

such other and further relief as it may deem just and proper.

Dated: January 31, 1955.

/s/ ORRIS R. HEDGES,  
/s/ LLOYD W. DINKELSPIEL,  
/s/ EDWARD W. ROSSTON,  
HELLER, EHRMAN, WHITE  
& McAULIFFE,  
Attorneys for Defendants

[Endorsed]: Filed Jan. 31, 1955.

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[Title of District Court and Cause.]

#### AMENDMENTS TO ANSWERS OF DEFENDANTS

Come now defendants above named and amending the Sixth Affirmative Defense in the Answer of Bay Rubber Company, a limited co-partnership, and the answers of each of said defendants so far as said Sixth Affirmative Defense is incorporated by reference in the Answer of each of them, add the following paragraph to follow Paragraph 54 in the Answer of said Bay Rubber Company:

“Paragraph 54A. The causes of action set forth in Plaintiff’s Complaint, and each of them, accrued more than two years prior to the filing of this action, and Plaintiff had knowledge of the facts upon which said causes of action and each of them are based more than two years before the filing of this action. Each of said causes of action is there-

fore barred by the provisions of Section 339(1) of the Code of Civil Procedure of the State of California."

Come now Defendants Wesley H. De Sellem and John B. Condrey, and amending Paragraph 6 of their Answer, add the following sentence at the end of said paragraph:

"Answering defendants further allege that the causes of action stated in the Complaint, and each of them, are barred by the provisions of Section 359 of the Code of Civil Procedure of the State of California, as well as by the other statutory provisions cited in Paragraphs 54 and 54A of the Answer of Defendant Bay Rubber Company, and that said causes of action, and each of them, are barred upon the same factual grounds as alleged in Paragraph 54 of the Answer of Defendant Bay Rubber Company."

/s/ ORRIS R. HEDGES

/s/ LLOYD W. DINKELSPIEL

/s/ EDWARD W. ROSSTON

HELLER, EHRLMAN, WHITE  
& McAULIFFE

Attorneys for Defendants.

It is hereby ordered that *that* Answers of Defendants may be amended in the foregoing particulars.

Dated: January 3, 1956.

/s/ O. D. HAMLIN

United States District Judge

Acknowledgment of Receipt of Copy attached.

[Endorsed]: Filed Jan. 3, 1956.

[Title of District Court and Cause.]

### STIPULATION

It is hereby stipulated by and between the parties hereto through their undersigned counsel that for the purpose of the instant action only, and for no other purpose, the following statements may be considered as true:

1. The United States personal income tax return of Poncet Davis for the year 1952 was filed with the proper Director of Internal Revenue on or about March 15, 1953.
2. The United States personal income tax return of Poncet Davis for the year 1953 was filed with the proper Director of Internal Revenue on or about June 1, 1954, pursuant to an extension of time duly granted.
3. The United States personal income tax return of Poncet Davis for the year 1954 was filed with the proper Director of Internal Revenue on or about March 15, 1955.

Dated: San Francisco, February 1, 1956.

/s/ ORRIS R. HEDGES

/s/ LLOYD W. DINKELSPIEL

/s/ EDWARD W. ROSSTON

HELLER, EHRLMAN, WHITE  
& McAULIFFE

Attorneys for Defendants.

/s/ HERBERT W. CLARK  
/s/ RICHARD J. ARCHER  
/s/ GEORGE BOUCHARD  
/s/ JAMES C. HERNDON

Attorneys for Plaintiff.

It is so ordered this 2nd day of February, 1956.

/s/ MICHAEL J. ROCHE

United States District Judge.

[Endorsed]: Filed Feb. 2, 1956.

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[Title of District Court and Cause.]

ORDER

Defendants' motion to dismiss is denied.

It is ordered that judgment be entered in favor of the defendants.

Defendants to prepare findings of fact and conclusions of law and judgment.

Findings shall include, *inter alia*, the following:

1. That plaintiff Robbins Tire and Rubber Company, a corporation, is the alter ego of Poncet Davis, and that the knowledge of Poncet Davis, who owned almost 100% of the stock of said Robbins Tire and Rubber Company, is the knowledge of said Robbins Tire and Rubber Company;

2. That Poncet Davis, individually and as the owner of all but the qualifying shares of stock of Robbins Tire and Rubber Company, had knowledge of and consented, with the other stockholder of Pacific Rubber Company, to the transfer by Pacific Rubber Company to Bay Rubber Company of the so-called synthetic rubber contracts;

3. That the synthetic rubber contracts were never transferred to Defendant Cameron, but were transferred to Bay Rubber Company by Pacific Rubber Company;
4. That the minutes and by-laws of Pacific Rubber Company provided for the holding of regular meetings and that the regular meetings of said corporation having to do with the transfer of the synthetic contracts were validly held;
5. That the consideration to Pacific Rubber Company for the transfer by it to Bay Rubber Company of the synthetic rubber contracts was fair and reasonable under the circumstances;
6. That Defendants Condrey, DeSellem, Pauley, Cameron and Bay Rubber Company did not conspire and agree to conceal from the plaintiff and did not conceal from the plaintiff the possession and transfer of the synthetic contracts.

Dated: March 19, 1956.

/s/ O. D. HAMLIN

United States District Judge.

[Endorsed]: Filed March 20, 1956.

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[Title of District Court and Cause.]

#### FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above entitled case having been tried by a court sitting without a jury, the court hereby makes

the following findings of fact and conclusions of law:

### Findings of Fact

#### I.

Defendants Edwin W. Pauley, C. L. Cameron, Wesley H. DeSellem and John B. Condrey are, and were at the time of the filing of the complaint herein, citizens and residents of California. Bay Rubber Company is a limited partnership doing business in the State of California. The matter in controversy herein exceeds the sum or value of \$3,000 exclusive of interest and costs.

Defendant Pacific Rubber Company (hereinafter referred to as Pacific) was at all times mentioned herein a corporation duly organized under and by virtue of the laws of the State of California with its principal office in said State in the County of Alameda. The stock of Pacific was at all times mentioned and is now owned 58.597% by defendant John B. Condrey and 41.403% by plaintiff Robbins Tire and Rubber Company (hereinafter referred to as Robbins). John B. Condrey purchased said stock with his own funds and at all times owned said stock in his own right.

#### II.

At all times mentioned in this action the Board of Directors of Pacific consisted of John B. Condrey, Wesley DeSellem and Glenn Taylor. Glenn Taylor was at all such times and still is a vice-president of Robbins, and at all times represented its interest on said Board of Directors.

### III.

Defendants Condrey and DeSellem at all times acted on the basis of their own independent judgment in connection with the matters of which plaintiff complains, and neither DeSellem nor Condrey was at any time mentioned in this action dominated or controlled by each other or by any of the other defendants or by any other person in taking such action.

### IV.

Plaintiff Robbins is a corporation duly organized and existing under and by virtue of the laws of the State of Alabama, having its principal office in said State in the City of Tuscumbia.

### V.

All but one of the outstanding shares of stock of plaintiff Robbins were at all times mentioned herein and are now owned by Poncet Davis, and the other outstanding share at all such times was and is now owned by the secretary of Poncet Davis in order to qualify for corporate office under the laws of the State of Alabama. At all times mentioned in this action said Poncet Davis was and now is the president of, and dominated and controlled, plaintiff corporation, and said corporation was and now is, particularly in connection with the matters of which plaintiff complains, the alter ego of Poncet Davis. Poncet Davis at various times, when it was convenient for him to do so, disregarded the separate, corporate entity of Robbins, and used Robbins to transact his personal business, and this practice of

Poncet Davis was well known to defendants. In the month of January, 1951, in connection with the dissolution of Pacific and the formation of Bay Rubber Company, said Poncet Davis stated to defendant Edwin W. Pauley that Davis was taking his partnership interest in Bay Rubber Company as "Poncet Davis, Trustee," so that said interest could go to himself personally, to his children or to Robbins, whichever Davis later considered best. Defendants believed said statement and acted in reliance thereon in connection with the matters which are the subject of the complaint on file herein.

## VI.

Prior to January 5, 1951, Pacific was an operating rubber company, and had among its assets a 35% participating interest in an agreement dated August 28, 1950, and executed by and between Minnesota Mining and Manufacturing Company (hereinafter referred to as Minnesota) and Reconstruction Finance Corporation (hereinafter referred to as RFC) for the reactivation and management of a government-owned synthetic rubber plant located at Torrance, California. Said participating interest was created by two written contracts between Pacific and Minnesota, dated September 29, 1950, under the terms of which Minnesota granted Pacific a 35% participating interest in the aforesaid reactivation and management contract, and Pacific assumed certain liabilities and duties in connection with the performance by Minnesota of said management contract. The contracts, on the

basis of which Pacific acquired such 35% participating interest, will hereinafter be collectively referred to as the "synthetic rubber contracts."

## VII.

Pacific was, at the end of the year 1950, in a precarious financial position because of its pressing debts, and had been for some time unsuccessfully attempting to dispose of its assets.

## VIII.

On or about January 5, 1951, at the office of Pacific, in Oakland, California, the shareholders of Pacific, to wit, Davis and Condrey, in a series of informal meetings with creditors, persons interested in buying Pacific or its assets, and certain other persons, orally agreed upon a plan for sale of the assets and dissolution of Pacific. Such plan provided (1) for the distribution of all the assets of Pacific, except the synthetic rubber contracts, to the shareholders of Pacific, and the sale by said shareholders of substantially all of such assets (excepting Accounts Receivable) to Pacific Tire and Rubber Company, a new corporation to be formed with a capitalization of \$300,000, 50% of which would be contributed by Inland Rubber Company (a wholly owned corporate subsidiary of Mansfield Tire and Rubber Company), and 50% of which would be contributed by a limited partnership to be formed, in which Edwin W. Pauley and Poncelet Davis were to be the principal partners (Davis' interest being a limited one); and (2) for the transfer of the synthetic rubber contracts by Pacific to said new

limited partnership for a nominal consideration, which transfer was to be effective as of January 15, 1951, regardless of the date of actual transfer after necessary consents (i.e., of Minnesota and of RFC, if required) could be obtained.

## IX.

On or about January 5, 1951, at a duly held special meeting of the Board of Directors of Pacific, at which all directors were present, and pursuant to the aforesaid plan of dissolution and sale to which all of the shareholders of Pacific had previously agreed, said directors unanimously resolved to wind up and dissolve the affairs of Pacific.

## X.

On or about January 5, 1951, at a duly called special meeting of the shareholders of Pacific, at which all the shareholders were present, and pursuant to the aforesaid plan of dissolution and sale, said shareholders unanimously adopted a resolution electing to wind up the corporate affairs of Pacific, and voluntarily to dissolve, and authorizing and directing the officers and directors of said corporation to take such further action as might be necessary or proper to wind up the affairs of said corporation and to dissolve it.

## XI.

On or about January 8, 1951, pursuant to said plan of dissolution and sale, a limited co-partnership was formed under the name of Bay Rubber Company (hereinafter referred to as Bay). The partners in said partnership, together with their

respective interests therein on said date, were as follows:

General Partner	Percentage interest
Edwin W. Pauley	51%
Limited Partners	
Poncet Davis, Trustee	35%
Earl W. Booz	1%
John B. Condrey	1%
Orris R. Hedges	1%
C. L. Cameron	1%
Wm. R. Pagen, Trustee	10%

The articles of co-partnership of Bay were amended on December 28, 1951, at which time the following changes in ownership became effective:

General Partners	Percentage interest
Edwin W. Pauley	51%
C. L. Cameron	1%
Limited Partners	
Poncet Davis, Trustee	36%
Earl W. Booz	1%
John B. Condrey	1%
Orris R. Hedges	1%
Donald R. MacPherson	1/2%
Wm. R. Pagen	1/2%
J. L. Hayes	4%
J. L. Hayes, Trustee	4%

## XII.

Poncet Davis has never executed a trust covering the limited partner's interest in Bay held in the name of "Poncet Davis, Trustee," and said interest, in fact, is now and at all times mentioned herein

has been held for the benefit of Ponceet Davis, individually.

### XIII.

Ponceet Davis, individually, and as the owner of all but one qualifying share of the stock of Robbins, prior to December 14, 1951, had full knowledge of the value of the synthetic rubber contracts, of the terms on which Pacific had acquired a 35% participating interest therein, of the aforesaid plan for dissolution of Pacific, and sale of its assets, as well as of the transfer, and the terms and time of transfer of said synthetic rubber contracts from Pacific to Bay, of the cash consideration paid by Bay to Pacific for such transfer, and of the assumption of Pacific's liabilities under said contracts by Bay in consideration of said transfer. The terms, time and consideration for said transfer were in accordance with the aforesaid plan of dissolution and sale; and said Ponceet Davis, individually, and as owner of all but one qualifying share of the stock of Robbins, and acting on behalf of Robbins, together with John B. Condrey, the other stockholder of Pacific, with full knowledge of all such matters, consented to said plan, including the transfer of the said synthetic rubber contracts by Pacific to Bay at such time and on such terms and for such consideration.

Prior to the commencement of this action, neither plaintiff nor Ponceet Davis was informed by any of the defendants that on May 21, 1951, approximately \$100,000 in fees had accrued to Pacific on account of the synthetic rubber contracts with Minnesota and RFC.

Prior to the commencement of this action, neither plaintiff nor Poncet Davis was informed by defendants that under the terms of its contract with Minnesota, Pacific could voluntarily liquidate, dissolve or wind up its affairs so long as immediately thereafter its net worth was not reduced below \$500,000.

#### XIV.

The knowledge of Poncet Davis is the knowledge of Robbins, and the consent of Poncet Davis to the transfer of said synthetic rubber contracts from Pacific to Bay and to the time, terms and consideration for such transfer is the consent of Robbins and is binding upon it.

#### XV.

Said synthetic rubber contracts, in accordance with the aforesaid plan of dissolution and sale, were transferred, effective as of January 15, 1951, directly from Pacific to Bay, and were never transferred or distributed by Pacific to its shareholders, or to Claude L. Cameron, individually, or as trustee in liquidation for such shareholders, or to any other person.

#### XVI.

In consideration for the sale of all the assets of Pacific (except the synthetic rubber contracts) to Pacific Tire and Rubber Company, the shareholders of Pacific received a total payment of over \$1,000,000; and in consideration for the transfer of the synthetic rubber contracts from Pacific to Bay, Pacific received \$5,000 in cash, which was distributed to its shareholders, and Pacific was re-

lieved of its executory obligations under said synthetic rubber contracts and was able to wind up its affairs. As a result of the execution of the aforesaid plan of dissolution and sale, Robbins realized a capital gain of over \$400,000 on an \$8,000 investment in the stock of Pacific, and Condrey realized a capital gain of approximately \$580,000 on a \$12,000 investment in the stock of Pacific.

## XVII.

The consideration given by Bay to Pacific for the transfer of the synthetic rubber contracts was just and reasonable under all the circumstances.

## XVIII.

The synthetic rubber contracts were terminable on ten days' notice by RFC and upon ninety days' written notice by Minnesota, and expired by their terms on June 30, 1952. On June 30, 1952, Pacific was in dissolution, and was consequently not in a position to perform any of its duties or obligations under said contracts, or to seek renewal or extension thereof. From and after January 15, 1951, Bay did, in fact, assume and perform all of the obligations of Pacific and pay all of the expenses charged to the account of Pacific under said synthetic rubber contracts. Said contracts were renewed on a month-to-month basis from and after June 30, 1952, and said monthly renewals were obtained entirely through the efforts of Bay and were made for the benefit of Bay.

Bay Rubber Company received \$792,217.41 from Minnesota on account of the synthetic rubber con-

tracts. Poncet Davis has received in cash from Bay Rubber Company the sum of \$61,538.47, of which \$14,000.00 represented the repayment of a loan; and the partnership account of Poncet Davis in Bay Rubber Company has been credited with his entire partnership share of the balance of the proceeds of the synthetic rubber contracts received by Bay Rubber Company.

## XIX.

The synthetic rubber contracts were formally transferred by Pacific to Bay by an instrument dated May 21, 1951, which instrument was validly executed by the corporate officers of Pacific acting within their powers and pursuant to a prior agreement of the shareholders of Pacific providing for and authorizing such transfer. Said officers acted pursuant to a resolution unanimously adopted at a special meeting of the shareholders of Pacific, regularly held on January 5, 1951, authorizing and directing them to take such action as might be necessary or proper to wind up the affairs of the corporation and dissolve it, and in accordance with a resolution of the Board of Directors of Pacific adopted at a special meeting held on the same date, electing to wind up and dissolve said corporation. Said officers also acted pursuant to a resolution of said Board of Directors, expressly authorizing them to execute such transfer, which resolution was duly adopted at a regular meeting of said Board, validly held without notice in accordance with the provisions of the by-laws and minutes of Pacific, on the

third Monday of May, 1951, to wit, May 21, 1951. A quorum of said Board of Directors, entitled to vote on such latter resolution authorizing the transfer of said synthetic rubber contracts to Bay, to wit, two directors, was present at said meeting, and neither of said directors there present had any financial interest in the transaction. Each of the directors present at such meeting, acting independently, in the exercise of his best judgment, voted in favor of the adoption of the resolution authorizing said transfer, and such action of the Board of Directors of Pacific was taken in accordance with the aforesaid plan for dissolution of Pacific and sale of its assets, theretofore accepted by all of the shareholders of said corporation, and was a regular and valid action of said Board. No formal notice of the meeting of the Board of Directors of Pacific on May 21, 1951, was given to Glenn A. Taylor, and such notice was not required since said meeting was a regular meeting of the Board of Directors, and notice was not necessary under the by-laws of the corporation. Glenn A. Taylor did not attend such meeting.

Glenn A. Taylor was elected a director of Pacific at or about the time of the first meeting of its Board of Directors. At the first meeting of said Board of Directors, a resolution was adopted authorizing the holding of regular meetings of said Board without notice on the third Monday of each month at the hour of 10:00 o'clock A.M. at the principal office of the corporation. Minutes reflecting the adoption of this resolution were prepared and bound up in

the minute book of the corporation shortly after the date on which said meeting was held, and at all times thereafter remained in the corporate minute book, available for the inspection of Glenn A. Taylor, and said minutes containing such resolution were in the minute book of the corporation on every occasion when the said Glenn A. Taylor attended a meeting of the Board of Directors of the corporation or visited the offices of the corporation.

Only directors Wesley H. DeSellem and John B. Condrey attended the meeting of the Board of Directors of Pacific on May 21, 1951. The fact that director John B. Condrey was a limited partner in Bay Rubber Company was not noted in the minutes of that meeting. Condrey's interest in the transfer of the synthetic rubber contracts to Bay Rubber Company was not adverse to the interest of Pacific Rubber Company, but on the contrary, coincided with it. Condrey owned a 1% limited interest in Bay Rubber Company, and a 58.597% interest in Pacific Rubber Company.

## XX.

Poncet Davis, with full knowledge of the value and terms of said synthetic rubber contracts, of the fact and time of their transfer to Bay from Pacific, of the consideration given Pacific by Bay for the transfer, and of all facts surrounding the transfer, accepted without protest money from Bay, the source of which Davis knew or reasonably should have known was, and which was in fact, management fees received by Bay under said synthetic rubber contracts after such transfer was completed.

**XXI.**

Robbins, with full knowledge of the value and terms of said synthetic rubber contracts, of the fact and time of their transfer to Bay from Pacific, of the consideration given Pacific by Bay for the transfer, and of all facts surrounding the transfer, without protest, allowed Pacific to derive benefits from said transfer and accepted its share of the cash consideration given by Bay to Pacific for such transfer upon the liquidation of Pacific and distribution of its assets (including such cash consideration) to its shareholders.

**XXII.**

Robbins made no demand on defendant Pacific prior to the filing of this action, requesting that the transfer of the synthetic rubber contracts to Bay be set aside, and under all the circumstances, such a demand, if it had been made, would not have been futile.

**XXIII.**

Plaintiff has been unduly dilatory in filing this action and defendants have been prejudiced by such delay.

**XXIV.**

Defendants Condrey, DeSellem, Pauley, Cameron and Bay neither collectively nor individually conspired with each other or with any third person or persons to conceal from or misrepresent to Robbins or Davis the terms upon which Pacific had a participating interest in the synthetic rubber contracts, the transfer of the synthetic rubber contracts from

Pacific to Bay, the value of said contracts, the consideration given by Bay for the transfer of said contracts, the time of the transfer, or any other fact related to such transfer; and none of said defendants concealed from or misrepresented or failed to disclose to Robbins or Davis any of such matters, but, in fact, said defendants made a full and true disclosure of all such matters to Robbins and to Davis at or about the time said transfer was authorized and made.

### XXV.

Robbins has not been damaged in any sum by reason of the transfer of said synthetic rubber contracts from Pacific to Bay.

### Conclusions of Law

#### I.

The transfer by Pacific of its interest in the synthetic rubber contracts to Bay was regularly and validly made.

#### II.

Robbins has already received the entire share of management fees derived from the synthetic rubber contracts to which it is legally entitled, and Bay is legally entitled to retain the entire share of the management fees collected by it under the synthetic rubber contracts for the period of operations under said contracts from and after January 15, 1951, until termination of such contracts.

#### III.

Neither defendant Cameron, Pauley nor Bay ever had any fiduciary relationship or duty to Rob-

bins in connection with the holding of, operation under or collection of management fees from the synthetic rubber contracts.

#### IV.

Neither defendant DeSellem nor defendant Condrey violated his duty as a director of Pacific to Robbins as a shareholder of Pacific in connection with any of the transactions which are the subject of the complaint on file herein.

#### V.

The meeting of the Board of Directors of Pacific on May 21, 1951, which adopted a resolution authorizing the transfer of the synthetic rubber contracts to Bay for a cash consideration of \$5,000 was a regular meeting, validly held; there was a quorum present at such meeting entitled to vote on said resolution; and said resolution was validly adopted by such meeting. Neither DeSellem nor Condrey was "financially interested" in the transaction which was the subject of such resolution within the meaning of California Corporations Code, §820.

#### VI.

The consideration received by Pacific for the transfer of the synthetic rubber contracts to Bay was just and reasonable under all the circumstances.

#### VII.

Robbins is the alter ego of Poncet Davis, and is chargeable with Davis' knowledge of the transactions which are the subject of the complaint on file

herein, and is bound by Davis' consent thereto and acceptance of benefits thereunder.

### VIII.

Robbins' action is barred by the statute of limitations because Robbins had full knowledge of all the facts on which its action is based more than three years prior to the filing of this action.

### IX.

Robbins, with full knowledge of the facts on which its action is based, consented to all the transactions and acts of which it complains, and consequently, has ratified said transactions and acts, and has waived its right to challenge them.

### X.

Robbins, with full knowledge of the facts on which its action is based, accepted benefits resulting from the completion of the transactions of which it complains, and has thereby ratified said transactions, and is estopped to challenge their validity or fairness.

### XI.

Robbins, with full knowledge of the facts on which its cause of action is based, failed to institute this action for an unduly long period of time, during which period Robbins accepted benefits from resulting from the completion of the transactions of which it now complains. During such period of delay, defendants irrevocably changed their position and were prejudiced by Robbins' dilatory

tactics. Robbins' action is accordingly barred by laches.

### XII.

Defendants Condrey, DeSellem, Pauley, Cameron and Bay did not conspire with each other or with any third persons to conceal from Robbins or misrepresent to Robbins the facts on which Robbins' action is based; nor did any of such defendants conceal from or fail to disclose to Robbins, or misrepresent to Robbins any of such facts.

### XIII.

Robbins suffered no damage from the transfer of the synthetic rubber contracts by Pacific to Bay.

### XIV.

Robbins is not entitled to recover its attorneys' fees incurred in connection with this action.

### XV.

Defendants are entitled to recover their costs incurred in connection with the defense of this action.

Dated this 22nd day of May, 1956.

/s/ O. D. HAMLIN

United States District Judge.

[Endorsed]: Filed March 22, 1956.

In the United States District Court, Northern  
District of California, Southern Division

No. 34294

ROBBINS TIRE AND RUBBER COMPANY,  
INCORPORATED, a corporation,

Plaintiff,

vs.

BAY RUBBER COMPANY, a limited co-partnership, EDWIN W. PAULEY, C. L. CAMERON, WESLEY H. DeSELLEM, JOHN B. CONDREY, PACIFIC RUBBER COMPANY, a corporation, ONE DOE, TWO DOE, THREE DOE, ONE DOE CORPORATION, TWO DOE CORPORATION and THREE DOE CORPORATION, Defendants.

### JUDGMENT

The above entitled case having come on regularly to be heard before the Honorable O. D. Hamlin, United States District Judge of the above entitled court, sitting without a jury, oral and documentary evidence having been adduced on behalf of all parties, and the court having heard oral argument and having examined the briefs filed herein, and being fully advised in the premises,

It is hereby ordered, adjudged and decreed that the complaint be dismissed on the merits, that judgment be entered for defendants, and each of

them, and that defendants recover from plaintiff their costs incurred in this action.

Dated: May 22, 1956.

/s/ O. D. HAMLIN

United States District Judge.

Entered in Civil Docket 5/22/56.

Receipt of Copy acknowledged.

[Endorsed]: Filed May 22, 1956.

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[Title of District Court and Cause.]

#### NOTICE OF APPEAL

Notice is hereby given that plaintiff, Robbins Tire and Rubber Company, Incorporated, a corporation, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the judgment in this action filed and entered on May 22, 1956.

Dated: San Francisco, June 5, 1956.

/s/ HERBERT W. CLARK

/s/ RICHARD J. ARCHER

/s/ GEORGE BOUCHARD

/s/ JAMES C. HERNDON

Attorneys for Plaintiff.

MORRISON, FOERSTER, HOLLOWAY, SHUMAN & CLARK,  
Of Counsel.

[Endorsed]: Filed June 6, 1956.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD  
ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and constitute the record on appeal herein as designated by the Attorneys for the Appellant:

Excerpt from Docket Entries.

Complaint.

Answer of Bay Rubber Company.

Answer of Edwin W. Pauley and C. L. Cameron.

Answer of Pacific Rubber Company.

Answer of Wesley H. DeSellem and John B. Condrey.

Notice and Motions by Plaintiff for orders compelling answers in discovery proceedings, with supporting affidavits and excerpts from depositions.

Order Denying Motions for order compelling answers in Discovery Proceedings.

Amendments to Answers of Defendants.

Stipulation and Order re income tax returns.

Order of Court for Judgment.

Findings of Fact and Conclusions of Law, prepared and lodged by defendants.

Proposed Modifications to Findings of Fact and Conclusions of Law, prepared by plaintiff.

Memo (letter) of defendants on findings of fact and conclusions of law.

Memo of corrections to transcript.

Memo (letter) of defendants on corrections to transcript.

Findings of Fact and Conclusions of Law.

Judgment.

Notice of Appeal.

Appeal Bond.

Designation of Plaintiff for record on appeal.

Reporter's transcript of proceedings March 2, 1956.

Reporter's Transcript of proceedings Dec. 12, 16, 19, 20, 21, 1955 and Jan. 4, 5, and 6, 1956.

Plaintiff's Exhibits: 1, 2, 3, 4-a, 4-b, 5, 5-a, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 19-a, 20, 21, 22, 23, 24, 24-a, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 49-a, 50, 51, 52, and 53.

Defendants' Exhibits: A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, Q-1, Q-2, Q-3, Q-4, Q-5, Q-6, Q-7, R, S, T, U, V, W, X and Y.

In witness whereof, I have hereunto set my hand and affixed the seal of said Court this 16th day of July, 1956.

[Seal]

C. W. CALBREATH,  
Clerk,

/s/ By MARGARET BLAIR,  
Deputy Clerk.

In the United States District Court for the Northern District of California, Southern Division

No. 34294

ROBBINS TIRE & RUBBER CO., Plaintiff,

vs.

BAY RUBBER CO., et al., Defendants.

REPORTER'S TRANSCRIPT

Friday, December 16, 1955

Before: Hon. Oliver D. Hamlin, Judge.

Appearances: For the Plaintiff: Messrs. Morrison, Foerster, Holloway, Shuman & Clark, by Herbert W. Clark, Esq. and Richard J. Archer, Esq.; Messrs. Bouchard & Little, by George Bouchard, Esq.; James C. Herndon, Esq., Akron, Ohio. For the Defendant: Orris R. Hedges, Esq.; Messrs. Heller, Ehrman, White & McAuliffe, by Lloyd Dinkelpiel, Esq. and Edward W. Rossten, Esq. [1]\*

\* \* \* \* \*

Mr. Dinkelpiel: Now at this time I wish to make a motion without arguing it too much at length, because probably it would be unfair to ask your Honor to rule on it without having heard more of the facts of the case, but for the preservation of the record I wanted to move to dismiss all of this case as to the defendants Edwin W. Pauley, C. L.

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\* Page numbers appearing at top of page of original Reporter's Transcript of Record.

Cameron, and Pacific Rubber Company as not proper parties. There is no allegation of any liability upon them. [16] There is no tie-in between them and any responsibility. That is to the defendants Pauley, Cameron and Pacific Rubber Company. Their only allegations as to them are some very loose allegations as to conspiracy on page 4 of the complaint, paragraph 15. There is a reference to conspiracy and you see they are alleged to have conspired and agreed to conceal certain things. I don't think, as your Honor will note, that the allegations of conspiracy is sufficiently stated. I am positive that the evidence will not sustain it. I shouldn't say "positive," I expect that the evidence will not sustain it.

Now, separately, I would like to move your Honor for the dismissal of the action as to the two directors Wesley H. DeSellem and John B. Condrey as no allegations sufficient to impose upon them personal liability has been stated nor will there be any proof in my opinion sustaining such liability.

This I believe will leave the action as it should be, if there is any, the plaintiff's right hand suing the plaintiff's left hand with the exception for a small differential. [17]

\* \* \* \* \*

(Copy of articles of co-partnership received in evidence as Plaintiff's Exhibit 2.)

## PLAINTIFF'S EXHIBIT No. 2

Articles of Co-Partnership of Bay Rubber  
Company, A Limited Partnership

This Agreement made and entered into on this 8th day of January, 1951, by and between Edwin W. Pauley, residing in Los Angeles, California, First Party, and Poncet Davis, Trustee, residing in Akron, Ohio, Earl W. Booz, residing in Oakland, California, John B. Condrey, residing in Berkeley, California, Orris R. Hedges, residing in Los Angeles, California, C. L. Cameron, residing in Los Angeles, California, and William R. Pagen, Trustee, residing in Los Angeles, California, Second Parties.

Witnesseth:

1. The parties hereto do hereby form a limited or special partnership for the purpose of engaging in the business of the manufacture and sale of all types of rubber products and kindred articles, with the principal office of business in the City of Los Angeles, County of Los Angeles, State of California, and in such other place or places as may hereafter from time to time be agreed upon.

2. The business of the partnership shall be conducted under the firm name and style of "Bay Rubber Company" and the place at which the business of the partnership shall be transacted is 717 North Highland Avenue, Los Angeles 38, California, or such other place or places as may from time to time be agreed upon.

3. The partnership shall commence on the 8th day of January, 1951, and shall continue until July 1, 1955, and thereafter from year to year until terminated as herein provided.

4. The name, address and designation of each of the partners hereto is as follows:

Edwin W. Pauley, General Partner, 9521 Sunset Boulevard, Beverly Hills, California.

Ponce Davis, Trustee, Limited Partner, Mayflower Hotel, Akron, Ohio.

E. W. Booz, Limited Partner, Hillecastle Apartments, Oakland, California.

John B. Condrey, Limited Partner, 2818 Piedmont Avenue, Berkeley, California.

Orris R. Hedges, Limited Partner, 1551 Midvale, West Los Angeles, California.

C. L. Cameron, Limited Partner, 232 South Hamilton Drive, Beverly Hills, California.

William R. Pagen, Trustee, Limited Partner, 2531 South Westgate Avenue, Los Angeles, California.

5. Edwin W. Pauley shall be the general partner. Ponce Davis, Trustee, Earl W. Booz, John B. Condrey, Orris R. Hedges, C. L. Cameron and William R. Pagen, Trustee, shall be limited partners. Each of the partners shall contribute to the capital of the partnership the amount set opposite his name.

General Partner	Cash Contributed
Edwin W. Pauley	\$76,500.00
Limited Partners	
Ponce Davis, Trustee	52,500.00

Earl W. Booz	1,500.00
John B. Condrey	1,500.00
Orris R. Hedges	1,500.00
C. L. Cameron	1,500.00
William R. Pagen, Trustee	15,000.00

6. The net profits of the partnership shall be divided among the partners and the net losses shall be borne by them in the proportions set opposite their respective names.

General Partner

Edwin W. Pauley	51%
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Limited Partners

Poncet Davis, Trustee	35%
Earl W. Booz	1%
John B. Condrey	1%
Orris R. Hedges	1%
C. L. Cameron	1%
William R. Pagen, Trustee	10%

Notwithstanding anything to the contrary herein contained, the liability of any of the limited partners for the losses of the partnership shall in no event exceed in the aggregate the amount of their contributions to the capital of the partnership.

\* \* \* \* \*

8. There shall be kept at all times during the continuance of the partnership, full and correct books of account wherein the partnership shall enter, as well, all moneys by them or any of them, received, paid, laid out or expended in and about the business, as also all goods, wares, commodities and merchandise, bought or sold by reason or on

account of the business, and all other matters and things whatsoever to the business and management thereof in any wise belonging. Said books of account and all papers, writings and other documents of the partnership shall be kept at the principal place of business of the partnership and each partner shall individually or through his agent or agents have free access at all reasonable times to examine said books of account and other records and to make copies of the same. Said books of account shall be closed and the profits and losses of the business fixed and ascertained, and the accounts thereof adjusted on the 31st day of December, 1951, and thereafter said books of account shall be closed and the profits and losses fixed and ascertained.

9. On or before the 15th day of February in each year, commencing February 15, 1952, a general account shall be made and taken by the partners showing all purchases, receipts, payments, engagements, and transactions of the partnership during the immediate preceding year ending December 31, and all capital, property, engagements and liabilities for said period, and the said general account shall, immediately after the same shall be taken, be reduced to writing and examined by each of said partners, whereupon said account, as so rendered and approved by said partners, shall be kept with the books of the partnership and thereafter each of said partners shall be bound by every entry and statement of account therein contained, except that if any manifest error be found therein by any of the partners within two (2) months after the ren-

dering or stating of said account, then the said error shall be rectified and said account, so corrected or modified, shall be binding upon said partners in the same manner as above stated.

\* \* \* \* \*

11. During the continuance of this partnership the rights and liabilities of the general partner and limited partners respectively shall be as follows:

(a) The general partner shall use his best efforts to operate and manage the business of the partnership; it being understood that he has other business and personal interests and that a substantial portion of his time may be required in the management of said other interests. Each of said partners hereby agrees that the general partner shall have full power and authority to do any and all things necessary or proper to operate and manage said partnership business. He shall receive no compensation for his services but shall be entitled to reimbursement for his out-of-pocket expense in the operation and management of the partnership business.

(b) Any limited partner shall have the right to withdraw or reduce his contribution to the capital of the partnership upon December 31 of any year, commencing December 31, 1955, provided that at least four months prior written notice of the intention to withdraw or reduce such contribution shall have been sent by such limited partner to the general partner to the principal office of the partnership. In addition, any limited partner shall have the right to withdraw his capital contribution upon termination or dissolution of the partnership. Not-

withstanding the foregoing, no part of the capital contribution of any limited partner shall be withdrawn unless all liabilities of the partnership, except liabilities to the general partner and to limited partners on account of their contributions, have been paid, or unless the partnership has assets sufficient to pay them. No limited partner shall have the right to demand or receive property other than cash in return for his contribution and no limited partner shall have priority over any other limited partner, either as to contributions to capital or as to compensation by way of income. After any withdrawal of capital by a limited partner, his share in the profits and losses shall be in the proportion which his reduced capital bears to the total capital of the partnership on the date of such withdrawal; and the shares of the other partners shall be increased in the proportions in which they have theretofore shared the profits and losses of the partnership. \* \* \* \* \*

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### JOHN CONDREY

called as a witness on behalf of the Plaintiff,  
sworn. [20]

#### Direct Examination

Q. (By Mr. Clark): Mr. Condrey, state your full name, please? A. John B. Condrey.

Q. Where do you live?

A. 48 Mosswood Road, Berkeley.

The Court: Keep your voice up, please.

The Witness: 48 Mosswood Road, Berkeley, California.

(Testimony of John Condrey.)

Q. (By Mr. Clark): Where are you employed, Mr. Condrey?

A. I am employed in Oakland at the Pacific Tire & Rubber Company.

Q. How long have you been employed by Pacific Tire & Rubber Company?

A. Since its formation, January 16th, 1951.

Q. And do you occupy any official position or any office with Pacific Tire & Rubber Company?

A. I do.

Q. What is that office?

A. Treasurer of the corporation.

Q. What was your employment before January 16th, 1951?

A. I was employed by Pacific Rubber Company.

Q. A corporation. And how long had you been employed by that company? How long were you employed?

A. Since its formation, December 28th, 1948.

Q. From the time of its organization? [23]

A. Yes.

Q. And are you still employed by that company?

A. I don't understand the question.

Q. Well, are you still employed by Pacific Rubber Company as well as by Pacific Tire & Rubber Company?

A. It's in dissolution. I am not certain whether I am still employed.

Q. You were a director of Pacific Rubber Company, were you? A. I was.

Q. For how long, from the time of its organization?

(Testimony of John Condrey.)

A. From the time of its organization.

Q. Until the date of its dissolution or liquidation, or dissolution, rather?      A. That's right.

Q. And you are still acting as director in liquidation of that corporation, are you not?

A. That is right.

Q. How many directors did Pacific Rubber Company have?      A. Three directors.

Q. Name them, please. Yourself—who are the other two?

A. Wesley H. DeSellem and Mr. Glen Taylor.

Q. Who is Mr. Glen Taylor?

A. He was Vice President of Robbins Tire & Rubber Company.

Q. And who is DeSellem, or what was he?

A. He was Vice President and Treasurer of Pacific Rubber [24] Company.

Q. And a member of the Board of Directors?

A. That's right.

Q. Has the personnel of that Board of Directors ever been changed, Pacific Rubber Company?

A. No.

Q. It's the same now as it was when the corporation was organized, is that correct?

A. That's correct.

Q. Were you a stockholder in Pacific Rubber Company?      A. I was.

Q. You are now?      A. I am now.

Q. And you have been continuously?

A. I have.

(Testimony of John Condrey.)

Q. Was Mr. DeSellem ever a stockholder in Pacific Rubber Company? A. He was not.

Q. He was a paid employee?

A. Right, correct.

Q. You were Secretary of Pacific Rubber Company, too, were you not?

A. Secretary of Pacific Rubber Company, yes.

Q. From when until when?

A. From its formation until— [25]

Q. January 28, 1951—

A. January 15th—

Q. You tell me.

A. Excuse me. Its formation was December 28, 1948.

Q. That's right. A. From that date.

Q. Down to now? A. That's right.

Q. You are still secretary? Is one of your functions as secretary that of keeping the minutes of the corporation? A. That's correct.

Q. Will you describe the process, please, of formulating the minutes of Pacific Rubber Company? A meeting was held of the Board of Directors, or of the stockholders, and then what did you do?

A. I ordered the minutes to be written, typed, and placed in the minute book.

Q. To whom did you give that order?

Mr. Dinkelspiel: When, Mr. Clark?

Q. (By Mr. Clark): I am asking for his general practice now. We'll get down to the particulars. This is largely preliminary, if your Honor please.

To whom did you give such order?

(Testimony of John Condrey.)

A. To a secretary or stenographer who would perform the act of typing them. [26]

Q. All right. And what did she use for the purpose of deriving information as to what had happened?

A. Information that I had given her.

Q. And how did you give her that information? Orally or in memorandum form?

A. Either way, from notes that I had taken at a meeting or information that I had.

Q. Let me put the question in a different form. Did you dictate the notes to a stenographer, did you dictate the minutes to a stenographer?

A. I did.

Q. Was that your uniform practice?

A. That was my uniform—

Q. You drew all the minutes of Pacific Rubber Company in that way? A. That's right.

Q. You, yourself, dictated all of the minutes from the organization meeting, from and including the organization meeting down to and including the present day you have done that?

A. That's right.

Q. You know they are correct then?

A. Yes.

Q. Do you know what the stockholders' interest, each stockholder's was in Pacific Rubber Company, a corporation? [27]

A. There were two Pacific Rubber Companies, which one?

Q. This is the old one, the first one.

(Testimony of John Condrey.)

A. The old one, which later became Oakland Rubber Company.

Q. That's right. E. W. Pauley owned what percent of the total stock?

A. Approximately 51 percent.

Q. 51 percent plus. Poncet Davis was a stockholder, wasn't he? A. Yes.

Q. And he owned what percent?

A. Approximately 35 percent.

Q. And the remainder of the 100 percent was owned by whom?

A. Scattered share holders, small share holders.

Q. Rather a large number, some 13 percent?

A. Yes. You were asking me what date, which date?

Q. I am asking you up to December 12, 19—December 28, 1948? A. At that time?

Q. Yes, at that time. Now, it is a fact, isn't it, the name of Pacific Rubber Company was changed in December of 1948? A. That's correct.

Q. On December 28, 1948?

A. That's right.

Q. Is that your recollection? And it was changed to Oakland [28] Rubber Company, is that right?

A. Yes.

Q. Now what did Oakland Rubber Company do with its assets on December 28, 1948?

A. Oakland Rubber Company sold its assets to a new corporation that was formed bearing the same name as the name of Pacific Rubber Company.

Q. Sold its assets to Pacific Rubber Company, a

(Testimony of John Condrey.)

new corporation. Do you remember when that corporation was formed?

A. It was formed simultaneous with the change of name.

Q. All right. Who owned and now owns the stock of Pacific Rubber Company, the new corporation?

The Court: The distinction between the old company and the new company is that the first was Pacific Rubber Co. and the new is Pacific Rubber Company, is that right?

Mr. Clark: No, they are exactly the same name, if your Honor please. The distinction between the two is the stock holdings, that's about all.

The Witness: Yes.

Q. (By Mr. Clark): Who were the stockholders of Pacific Rubber Company, the new corporation?

A. Myself and Robbins Tire & Rubber Company Incorporated.

Q. And you owned how much of the stock of that company? You do own it?

A. 58.59701, I believe that is the correct figure.

Q. And the plaintiff in this case, Robbins Tire & Rubber Company?

A. Robbins Tire & Rubber Company, Incorporated, own the remaining 41.40299.

Q. Now how does it happen those decimal points are carried out so far, five points? What happened to the 13 percent of Pacific Rubber Company stock, that was the ownership of which was scattered?

(Testimony of John Condrey.)

A. That concerns a prior corporation which I had no interest in.

Q. You don't know what happened to that 13 percent? A. No.

Q. So you therefore don't know why the stockholdings, percentage figures showing stock holdings of the defendant Condrey, yourself and the plaintiff Robbins Tire & Rubber Company were carried out five decimal points? A. That's correct.

Q. Now, I think you have already testified that you were a director and are a director of Pacific Rubber Company, the new corporation, that DeSellem was a director and is now a director, is that right? A. That's correct.

Q. And that Glen Taylor was and still is a director? A. That's correct.

Q. And he was and is the Vice President of plaintiff [30] Robbins Tire & Rubber Company?

A. I believe he is.

Q. That is your information?

A. To my knowledge.

Q. Now when was Pacific Tire & Rubber Company formed?

A. Pacific Tire & Rubber Company was formed on or about January 16th, 1951. The articles of incorporation, I believe, were filed a few days prior to that, probably January 5th or thereabouts, 1951.

Q. And who were and are its stockholders?

A. Bay Rubber Company, a limited co-partnership, 50 percent, Inland Rubber Company, a corporation—I am not sure, Inland, 50 percent.

(Testimony of John Condrey.)

Q. You bought the stock that you had, you yourself bought the stock that you had and have in Pacific Rubber Company, the new corporation, did you?      A. I did.

Q. And what did you pay for it?

A. The capitalization was \$20,000 and my percentage of that was approximately eleven thousand some odd dollars.

Q. Something less than \$12,000 then?

A. 58 percent of \$20,000.

Q. Did you use your own money to do that?

A. That's right. [31]

\* \* \* \* \*

(Agreement marked Plaintiff's Exhibit 5 in evidence; Agreement marked Plaintiff's Exhibit 5-a in evidence.) [35]

\* \* \* \* \*

### PLAINTIFF'S EXHIBIT No. 5

#### Agreement

This Agreement, made and entered into as of the 20th day of September, 1950 by and between Minnesota Mining and Manufacturing Company, a corporation organized under the laws of the State of Delaware, (hereinafter referred to as "Minnesota"); and Pacific Rubber Company, a corporation organized under the laws of the State of California, (hereinafter referred to as "Pacific");

Witnesseth:

Whereas, as of the 28th day of August, 1950, Minnesota and Pacific entered into a lease and Op-

## Plaintiff's Exhibit No. 5—(Continued)

erating Contract (hereinafter called "Operating Contract") with the Reconstruction Finance Corporation (hereinafter referred to as "Reserve") to lease and operate Reserve's Synthetic Rubber plant at or near Los Angeles, California (hereinafter referred to as the "Plant"); and

Whereas, said Operating Contract provides for the participation by Pacific in the performance hereof and Minnesota and Pacific have entered into an Agreement in writing dated as of September 20, 1950, (hereinafter referred to as the "M-P Operating Agreement") setting forth their respective rights and duties with respect to the performance of said operations and the division of compensation received in respect thereto; and

Whereas, it is anticipated that certain inventions, improvements and/or discoveries may result from the operations of said Plant under said Operating Contract and/or from the conduct of research jointly by Minnesota and Pacific at said plant and/or elsewhere as the parties may hereafter agree, and the parties are desirous of setting forth their respective rights and duties with respect to the utilization of said inventions, improvements and/or discoveries, and in, to and under any Letters Patent which may be obtained with respect thereto;

Now, Therefore, in consideration of the promises and the mutual covenants herein contained, it is agreed by and between Minnesota and Pacific as follows:

Section 1. The term "Government Agency" shall

Plaintiff's Exhibit No. 5—(Continued)  
mean any department or instrumentality of the  
United States of America.

Section 2. The term "Synthetic Rubber" shall  
have the same meaning as that set forth in the  
Operating Contract.

Section 3. The term "Joint Operations" shall  
mean and include:

(a) All operations of the parties hereafter con-  
ducted by the parties under the Operating Contract  
and any other contract hereinafter entered into  
jointly by the parties with any Government Agency.

(b) Any operations conducted jointly by the par-  
ties pursuant to any written agreement between the  
parties.

Section 4. The term "Joint Inventions" shall  
mean any and all inventions, discoveries and/or im-  
provements (including but not limited to Synthetic  
Rubber) arising out of or derived from or procured  
with respect to Joint Operations.

Section 5. Minnesota and Pacific mutually and  
reciprocally agree that each will make available to  
the other, from time to time during the term of the  
said Operating Contract, all technical information  
which either of them now possesses or hereafter  
may acquire, relating to the manufacture of Syn-  
thetic Rubber and to processes and apparatus which  
are used, or may be used, in the manufacture of  
Synthetic Rubber, whether such Synthetic Rubber  
processes or apparatus have been patented, patents  
applied therefor, or whether the same are patent-  
able or unpatentable.

## Plaintiff's Exhibit No. 5—(Continued)

Minnesota and Pacific shall promptly transfer and make available to each other all technical information, of any nature or character whatsoever, in the possession of either or their employees, acquired in connection with or resulting from the operation under the said Operating Contract or this Agreement, which information each party shall be completely free to use in connection with the production of Synthetic Rubber (as defined and limited in the Operating Contract), regardless of whether such information be patented or unpatented, patentable or unpatentable.

Neither Minnesota nor Pacific shall have any obligation hereunder to pay any compensation, for any patents, inventions, improvements, or technical information owned or in the control of the other and used in the performance of said Operating Contract.

\* \* \* \* \*

Section 14. Minnesota and Pacific each agree to keep records and books of account of their respective sales and/or use of Patented Products. On or before the 20th day of January, April, July and October, Minnesota and Pacific shall deliver each to the other a report setting forth their respective sales and uses of Patented Products and the Total Value thereof in respect to the preceding quarter calendar year. Pacific shall accompany its report to Minnesota by payment of royalty in the amount of three per cent (3%) of its Total Value and the same shall be held by Minnesota as administrator of

## Plaintiff's Exhibit No. 5—(Continued)

the Research and Patent Fund. Minnesota shall credit to the Research and Patent Fund the amount of three per cent (3%) of its Total Value as shown on the said report. The books of account of each party shall be available to Certified Public Accountants designated by the other party as their qualified representatives for the purpose of checking once in each calendar quarter the accuracy of said reports and royalty payments. The reports of said Certified Public Accountants to the respective parties shall be limited to the accuracy of said reports and payments under the provisions of this Agreement and shall not under any circumstances include the transmission of any other information such as, without limitation to generality, any information as to customer lists or the amount of sales or use of any particular Patented Products.

\* \* \* \* \*

Section 16. Minnesota shall establish a separate account designated as the "Research and Patent Fund" into which it shall credit as income thereof:

- (a) All funds received by Minnesota and/or Pacific from any Government Agency for the purpose of conducting research.
- (b) The royalty paid by Pacific to Minnesota and the royalty credited by Minnesota, all as provided in Section 14 of this Agreement.
- (c) The full amount of all royalties paid to Minnesota by any third parties licensed by Minnesota

Plaintiff's Exhibit No. 5—(Continued)  
under M-P Patent Rights as provided in Section 9  
of this Agreement.

(d) The full value of any consideration received  
by Minnesota for the transfer of title of any M-P  
Patent Right as provided in Section 15 of this  
Agreement.

(e) Any monies received as the result of infringement  
litigation as provided in Section 18 of this  
Agreement.

Section 17. Minnesota shall charge as expense  
against said Research and Patent Fund:

(a) The actual cost of the conduct of any joint  
Program of Research.

(b) The entire amount of patent cost as provided  
in subsection (e) of Section 7 of this Agreement.

(c) The entire expense incurred by Minnesota in  
negotiation with third parties of licenses under  
M-P Patent Rights including the cost of attorneys  
services.

(d) The expense of infringement litigation as  
provided in Section 18 of this Agreement.

Section 18. (a) In the event that Minnesota or  
Pacific shall consider it necessary or desirable to  
bring action for infringement against any infringer  
of any M-P Patent Right, the party proposing such  
litigation shall fully advise the other party in writing  
with respect to such proposed litigation and such  
other party shall promptly advise the proposing party in writing as to whether or not it con-

Plaintiff's Exhibit No. 5—(Continued)  
curs in the necessity or desirability of such litigation. Failure by such other party to so advise the proposing party within thirty (30) days after receipt of said advice shall constitute concurrence by such other party unless the proposing party shall have granted additional time for such other party to determine its position.

(b) In the event Minnesota and Pacific shall concur as to such litigation the cost thereof shall be borne by the Research and Patent Fund except that, if the funds then in the Research and Patent Fund and paid thereto during the litigation are insufficient to pay for such litigation, the excess cost shall be paid on the basis of sixty-five (65%) per cent thereof by Minnesota and thirty-five (35%) per cent thereof by Pacific, unless and until either party shall have given not less than thirty (30) days written notice to the other of its election to withdraw from the further prosecution of such litigation, in which event the other party may continue such litigation at its own expense insofar as the cost shall exceed the funds then in the Research and Patent Fund and paid thereto during the litigation. Any sum of money recovered as damages as a result of litigation carried on by both parties as above provided shall be paid into the Research and Patent Fund as an item of income thereof. In the event of such withdrawal by one party the continuing party shall have the right to withhold the payment of any royalty to the Research and Patent Fund with respect to its utilization of M-P Patent Rights sub-

## Plaintiff's Exhibit No. 5—(Continued)

sequent to the date of withdrawal and until the termination of such litigation insofar as the obligation to pay royalty is dependent upon the determination as to validity and/or infringement of any claim or claims involved in such litigation. Upon the termination of such litigation the continuing party shall pay to the Research and Patent Fund the royalty so withheld only insofar as it shall be with respect to the utilization of inventions coming within the valid scope of the claim or claims as determined by such litigation. Any sum of money recovered as damages as the result of such litigation shall be applied: first, to the recoupment of the expense, if any, in excess of the funds of the Research and Patent Fund, incurred by the party continuing such litigation after withdrawal of the other party; second, to the recoupment of the Research and Patent Fund for expense paid therefrom; third, to recoupment of both parties of any excess cost paid by them prior to withdrawal of one party, (pro rata on the basis of contribution if the funds are insufficient for full recoupment); and finally the remainder, if any, shall be retained by the party continuing such litigation.

(c) In the event Minnesota or Pacific shall not concur as to litigation, considered necessary or desirable by Minnesota or Pacific, as the case may be, the party advocating such litigation may proceed alone at its own expense with no part of the cost of such litigation to be paid by the Patent and Research Fund. In such event the litigating party

## Plaintiff's Exhibit No. 5—(Continued)

shall have the right to withhold the payment of any royalty to the other party with respect to its utilization of M-P Patent Rights from the beginning of such litigation until the termination thereof insofar as the obligation to pay royalty is dependent upon the determination as to validity and/or infringement of any claim or claims involved in such litigation. Upon the termination of such litigation the litigating party shall pay to the Patent and Research Fund the royalty so withheld only insofar as it shall be with respect to the utilization of inventions coming within the valid scope of the claim or claims as determined by such litigation. Any sum of money recovered as damages as the result of such litigation shall be the sole property of the litigating party.

(d) The defense of an action brought by any third party for declaratory judgment with respect to the validity or infringement of any patent right shall be subject to the same provisions as above set forth in subsections (a), (b) and (c) of this Section 18 with respect to actions for infringement, except that Minnesota as administrator of M-P Patents may, in any event, and without the concurrence of Pacific, spend Patent and Research Funds in the defense of such an action in an amount not to exceed the net income of the Patent and Research Fund for the twelve months period immediately preceding the initiation of such an action.

(e) The terms expense or cost of litigation as used in this Section 18 shall mean the actual out-of-

## Plaintiff's Exhibit No. 5—(Continued)

pocket expense incurred in connection with said litigation including reasonable allocation of the compensation of employees of either party engaged in the conduct of such litigation but not including any allowance or apportionment whatsoever with respect to the compensation of any executive of either party or with respect to general overhead or administration expenses of either party. No item of interest shall be included either as to the expense of either party or as to the payment of withheld royalties.

(f) Minnesota agrees that, in the event Pacific shall elect to continue any litigation after the withdrawal of Minnesota as provided in subsection (b) or to proceed alone with litigation as provided in subsection (c), Pacific shall have the right to continue and/or conduct such litigation in the name of Minnesota to the extent necessary to enable Pacific to so continue and/or conduct such litigation.

Section 19. Minnesota and Pacific agree that each will keep full, true and accurate records and books of account with respect to their respective expenditures which are charged as expenses against the Research and Patent Fund as provided in this Agreement. On or before the 20th day of January, April, July and October of each year hereafter Pacific agrees to deliver to Minnesota a written statement setting forth in detail its expenditures, if any, during the preceding quarter calendar year with respect to which it should be reimbursed by the Research and Patent Fund. On or before the

**Plaintiff's Exhibit No. 5—(Continued)**

15th day of the second month after each such quarter calendar year, Minnesota, as administrator of the Research and Patent Fund agrees to deliver to Pacific a written statement showing Minnesota's expenditures during such quarter calendar year together with a complete statement showing the income of the Research and Patent Fund, the expenses thereof and the net income or loss thereof, as the case may be. Payment by Minnesota to Pacific of such sums of money as shall be due as reimbursement for expenses and thirty-five (35%) per cent of the net profits if any of the Research and Patent Fund shall accompany each such report. When and if any such report shall show a net loss, Pacific shall pay thirty-five (35%) per cent thereof to Minnesota within fifteen (15) days after the receipt of such report from Minnesota.

**Section 20.** Minnesota and Pacific reciprocally agree that the records and books of account provided to be kept by each in Section 19 of this Agreement shall be open, during reasonable business hours, for inspection by the other party through Certified Public Accountants (or employees thereof) selected by such party as its duly accredited representatives, to verify the reports and payments based thereon as provided in Section 19 of this Agreement.

**Section 21.** Minnesota and Pacific each agree to require such of their respective employees as shall be employed in connection with Joint Operations, to execute such employment contracts as are necessary to accomplish the purposes of this Agreement.

## Plaintiff's Exhibit No. 5—(Continued)

Section 22. This Agreement shall be binding upon the parties hereto and their respective successors to substantially the whole of their business. In the event that either Minensota or Pacific desire to sell, transfer and assign its rights under this Agreement, Minnesota or Pacific, as the case may be, shall notify the other in writing of the name of the proposed purchaser and all of the terms and conditions of the proposed sale, transfer, and assignment, and the party to whom the notice is delivered shall have a period of thirty (30) days from the date of the receipt of such notice within which to purchase the right of the other in, to and under this agreement upon the terms disclosed in such notice. In the event that the party receiving such notice fails to purchase the same within such thirty (30) day period, the party giving such notice of such proposed sale may sell its said rights to the party mentioned in such notice and upon the terms stated in such notice.

\* \* \* \* \*  
PLAINTIFF'S EXHIBIT No. 5-A  
Agreement

This Agreement, made and entered into as of the 20th day of September, 1950, by and between Minnesota Mining and Manufacturing Company, a corporation organized under the laws of the State of Delaware, (hereinafter referred to as "Minnesota"); and Pacific Rubber Company, a corporation organized under the laws of the State of California, (hereinafter referred to as "Pacific");

Plaintiff's Exhibit No. 5-A—(Continued)

Witnesseth:

Whereas, as of the 28th day of August, 1950, Minnesota and Pacific entered into a lease and Operating Contract (hereinafter called "Operating Contract") with the Reconstruction Finance Corporation (hereinafter referred to as "Reserve") to lease and operate Reserve's Synthetic Rubber plant at or near Los Angeles, California; and

Whereas, said Operating Contract provides for the participation by Pacific in the performance thereof;

Now, therefore, in consideration of the premises and the mutual covenants herein contained, it is agreed by and between Minnesota and Pacific as follows:

\* \* \* \* \*

Section 2. Pacific shall assist Minnesota in obtaining certain chemists, engineers and other personnel for full- or part-time employment by Minnesota in the performance of said Operating Contract. It is contemplated that in connection with the Operating Contract a pilot plant may be established and operated by Minnesota for the purpose of improving the quality of Synthetic Rubber, establishing lower production costs and to develop new Synthetic Rubbers. Minnesota and Pacific, when and as necessary and desirable, shall furnish personnel for full- or part-time employment by Minnesota in operating said pilot plant or to serve upon a technical committee to be appointed by Minnesota to advise in the operations of the said pilot plant.

## Plaintiff's Exhibit No. 5-A—(Continued)

Pacific shall assist Minnesota and/or Reserve in obtaining raw materials for the manufacture of Synthetic Rubber under said Operating Contract and shall assist in preparing a study of the postwar needs and uses of Synthetic Rubber products on the Pacific Coast.

\* \* \* \* \*

Section 4. Subject to the provisions of Sections 5 and 6, Minnesota shall pay to Pacific upon receipt thereof from Reserve, thirty-five per cent (35%) of the net proceeds received from Reserve as operating fees, reactivating fees in the event of termination, and all other compensation of every kind and character received by Minnesota for all operations performed under said Operating Contract.

Section 5. It is understood between Minnesota and Pacific that, in carrying out the terms of the Operating Contract, the amount paid by Minnesota for compensation to employees, employees' profit sharing, employees' pension costs and Social Security Taxes might not be reimbursed either in whole or in part by Reserve. The pension costs herein referred to shall be those costs to be incurred under Minnesota's pension plan now in effect. The Profit Sharing Costs shall be those costs to be incurred under Minnesota's Profit Sharing Plan now in effect, or those costs incurred under a special plan instituted for the employees employed under the Operating Contract, the cost of which shall not be greater than Minnesota's plan now in effect.

## Plaintiff's Exhibit No. 5-A—(Continued)

Minnesota shall maintain an account showing the total amount of gross fees received from Reserve and all expenses incurred by Minnesota and held to be non-reimbursable by Reserve.

It is further understood between Minnesota and Pacific that in determining the amount to be paid by Minnesota to Pacific under Section 4 hereof, the expenses incurred by Minnesota as aforesaid which are not reimbursed by Reserve shall be deducted by Minnesota.

Section 6. It is further understood between Minnesota and Pacific that there may be other expenses incurred by Minnesota and/or Pacific, other than those enumerated in Section 5, that are clearly not reimbursable by Reserve under the terms of the Operating Contract and such expenses if incurred by Minnesota shall be deducted in determining the amount to be paid by Minnesota to Pacific under Section 4 hereof and if incurred by Pacific, Pacific shall be reimbursed by Minnesota to the extent of 65% of such expenses, provided, however, that any said expenses must have the written approval of Minnesota or Pacific, as the case may be, before being incurred.

Section 7. To the extent that Minnesota is not reimbursed or held harmless by Reserve under the said Operating Contract, Pacific agrees to indemnify and pay over to Minnesota thirty-five per cent (35%) of any amount paid or expenses incurred by Minnesota (including attorneys fees, court costs and investigation expenses) in settlement or in

## Plaintiff's Exhibit No. 5-A—(Continued)

defense of claims of any kind whatsoever made by third persons for the destruction of property (whether owned by Reserve or others), or injury to, or death of said person or persons arising out of, or in any way connected with the performance of work under the Operating Contract. Minnesota shall notify Pacific with respect to all such claims and shall consult with Pacific with respect to the investigation, defense, settlement, or other disposition of all such claims, provided however, that, in the event of disagreement between Minnesota and Pacific, the decision of Minnesota shall be conclusive and binding upon Pacific. It is further understood and agreed that in the event Reserve directs Minnesota to insure against any of the matters covered by Section 2 of the Operating Contract and Minnesota fails, refuses or neglects so to do, then and in that event Pacific shall have no liability for any such claim or claims as in this Section provided.

Section 8. Pacific agrees that until its liability, if any, under Section 7 above has been satisfied or unless it first secures the written approval of Minnesota, it will not do any of the following acts if immediately thereafter its Net Worth is reduced below \$500,000:

(a) Sell, assign, transfer, lease or convey its property or business except as occasioned in the ordinary conduct of its business; voluntarily liquidate, dissolve, or wind up its affairs, or consolidate or merge with one or more corporations;

Plaintiff's Exhibit No. 5-A—(Continued)

- (b) Guarantee any obligation of any other person;
- (c) Mortgage, pledge or create any lien on any of its property;
- (d) Declare dividends payable in cash or in other property or make any distribution of assets of any kind, provided, however, that it shall not be prevented or restricted from making distributions in shares of stock of Pacific or any acquisitions of shares of stock of Pacific solely in exchange for other shares of stock of Pacific, or any acquisitions of shares of stock of Pacific through application of the proceeds of a substantially concurrent sale of other shares of stock of Pacific; and
- (e) Increase the compensation of its officers or directors or stockholders.

Pacific further agrees that it will keep insurance on its property to insure against hazards to the same extent that such insurance is generally maintained by corporations similarly situated.

Pacific agrees that it will make no payment to Oakland Rubber Company, a California Corporation, on account of principal or interest on any debt which is now or may be at any time hereafter owed to Oakland without the written approval of Minnesota.

\* \* \* \* \*

Section 12. The term of this agreement shall be co-extensive with, and limited to, the term of said Operating Contract.

\* \* \* \* \*

(Documents marked Plaintiff's Exhibit 6 in evidence.)

### PLAINTIFF'S EXHIBIT No. 6

This Agreement, made and entered into as of this 28th day of August, 1950, by and between Reconstruction Finance Corporation (hereinafter referred to as "Reserve"), Pacific Rubber Company (hereinafter referred to as "Pacific") and Minnesota Mining and Manufacturing Company (hereinafter referred to as "Operator");

Witnesseth:

Whereas, Reserve is the owner of a plant at or near Los Angeles, California, for the manufacture of synthetic rubber of the Butadiene-Styrene Copolymer type; and

Whereas, Reserve and Operator desire to enter into arrangements for the lease, operation and maintenance of said plant for Reserve; and

Whereas, Pacific will participate with Operator in the performance of this agreement in a manner hereinafter stated;

Now, therefore, in consideration of the premises and the mutual covenants herein contained, it is agreed by and between Reserve and Operator as follows:

Section 1. Subject to termination or cancellation as hereinafter provided, Reserve hereby agrees to lease, and does hereby lease (subject to outstanding easements, subleases or other agreements covering said plant, pending termination thereof) the said plant, including the site, buildings, machinery, equipment,

**Plaintiff's Exhibit No. 6—(Continued)**

materials and supplies, as the same or any portion or portions thereof exists upon the termination of said outstanding leases, subleases or other agreements and as thereafter at any time constituted and including additions, alterations, replacements, and improvements (hereinafter called the "Plant"), to Operator and Operator does hereby lease the same from Reserve for the term specified in Section 29 hereof. Reserve and Operator each agree, upon the written request of the other, to execute and deliver such additional instruments of lease as may be necessary to carry out the provisions and intentions of this agreement.

It is agreed that Pacific shall, under the terms of an agreement between Operator and Pacific, participate with Operator in the performance of this agreement but it is agreed that Reserve shall deal only with and be responsible only to Operator in the performance hereof and only Operator shall be responsible to Reserve for performance hereunder, unless herein or otherwise expressly provided.

Section 2. So long as this contract remains in full force and effect Operator shall procure and maintain insurance (provided such insurance is obtainable) of such kind and character as Reserve shall direct, and in such companies and in such amounts as shall be satisfactory to or required by Reserve, protecting against loss of or damage to the Plant or against liability to third parties by reason of the activities carried on by Operator pursuant to this contract or against such other con-

## Plaintiff's Exhibit No. 6—(Continued)

tingencies as may be specified by Reserve. The policies evidencing such insurance shall be made payable to Reserve or shall name it as an assured, as may be appropriate, and shall be delivered to Reserve. Any property acquired in replacement of property damaged or destroyed and as a result of application of any insurance proceeds shall be the property of Reserve and so identified and shall be subject to all the terms and provisions of this contract.

Section 3. Operator shall use reasonable care in the maintenance, use and operation of the Plant and shall keep the same in good state of repair. Upon the expiration, termination or cancellation of this contract, Operator shall forthwith yield and place Reserve in peaceful possession of the Plant free and clear of any liens and claims other than those resulting from claims against Reserve.

Section 4. Operator agrees to pay to the proper authority, when and as the same become due and payable (after approval by Reserve), all taxes, assessments, and similar charges, which at any time during the term of this contract may be lawfully taxed, assessed, or imposed upon Reserve or Operator with respect to or upon the Plant, or any part thereof. Operator also agrees to pay all claims or charges for or on account of water, light, heat, power and any other service or utility furnished to or with respect to the Plant, or any part thereof.

Section 5. In the maintenance and operation of the Plant and the performance of this contract,

## Plaintiff's Exhibit No. 6—(Continued)

Operator agrees to comply with and give all stipulations and representations required by all applicable Federal, State, municipal and local laws and all applicable rules, orders, regulations, and requirements of any governmental departments and bureaus and all local ordinances and regulations, provided that nothing herein contained shall be construed as preventing Operator from contesting in good faith the validity thereof or whether it has complied therewith. Operator further agrees to indemnify and hold Reserve harmless from any liability or penalty which may be imposed by local or State authority or any department or bureau thereof by reason of any violation or asserted violation by Operator of such laws, rules, orders, ordinances or regulations.

\* \* \* \* \*

Section 8. From and after the date of this contract, Operator, as Agent for Reserve, and for the account and at the expense and risk of Reserve, shall undertake all preparations, including reactivation of the second and third units of the Plant, sometimes referred to in the records of Reserve as plant II and plant III (hereinafter collectively called "Operating Facilities"), necessary for the subsequent operation and maintenance of the Operating Facilities for the production of synthetic rubber of the Butadiene-Styrene Copolymer type meeting specifications promulgated by the Committee on Specifications for Synthetic Rubbers, organized by Reserve, as such specifications may be from

## Plaintiff's Exhibit No. 6—(Continued)

time to time amended (said rubber to be hereinafter called "Synthetic Rubber").

Operator shall during the term of the lease hereunder perform the work necessary to protect, preserve and maintain the first unit of the Plant, sometimes referred to in the records of Reserve as plant I (hereinafter called "Standby Facilities") in accordance with the best accepted industrial practices and in accordance with such instructions as may be issued from time to time by Reserve.

## Section 9. \* \* \* \* \*

(b) Reserve shall reimburse Operator for Operator's costs hereunder, as herein defined, and shall pay to Operator the operating fee hereinafter specified in Section 13 hereof.

Section 10. For the purposes of this contract, Operator's costs hereunder shall mean all costs and expenses of whatsoever kind or character incurred by Operator in connection with the aforesaid reactivation, management, operation, repair, protection, preservation and maintenance of the Plant and the manufacture and production of Synthetic Rubber, including, but without limitation, the following:

(a) All salaries and wages, whether full-time or part-time, and including compensation for overtime, for work performed at the Plant or elsewhere, both in connection with preparations necessary for the operation of the Operating Facilities and in connection with the management, operation,

## Plaintiff's Exhibit No. 6—(Continued)

repair, protection, or maintenance of the Plant; all salaries and fees for services of technical, consultant-engineering or other professional experts, whether performed on or off the Plant site and whether on a full-time or part-time basis; all extra compensation paid to employees engaged in the performance of this contract and all discontinuance wages paid to such employees; the amount directly chargeable to Operator for all group insurance, retirement-income plan and all other welfare and employee-relation plans maintained by Operator for the benefit of employees engaged in the performance of this contract; and an equitably proportionate share of Operator's cost of all welfare and other employee-relation plans maintained by Operator for the benefit of its employees generally.

It is understood that in the event the full time of any employee of Operator is not applied to the performance of this contract, the wages or salary of such employee shall be included herein only in proportion to the actual time applied to the performance of this contract. It is further understood that the payment of any extra compensation or discontinuance wages and any expenditures, pursuant to the maintenance of welfare or other plans for the benefit of employees of Operator, shall be included herein only in so far as the payments or expenditures are consistent with Operator's general employee-relation policies throughout its organization, or are incurred pursuant to an agreement made as a result of collective bargaining with rep-

## Plaintiff's Exhibit No. 6—(Continued)

representatives of Operator's employees, or are expressly authorized in writing by Reserve, it being intended that employees of Operator in the Plant shall be treated no less favorably than other employees of Operator whose services are not used in the performance of this contract.

(b) The cost of all facilities, machinery, tools, dies, jigs, office equipment, supplies, manufacturing aids, alterations, improvements, replacements, and additions to the manufacturing buildings or equipment facilities connected therewith, required for the efficient performance of this contract and for which Operator is not otherwise reimbursed; and the cost of all maintenance and repairs including the cost of replacing, repairing or reconditioning any of the machinery or equipment comprising the Plant, damaged or destroyed, but only to the extent that the damage to or destruction of said machinery or equipment is not covered by insurance and only to the extent that the replacing, repairing or reconditioning is necessary to the efficient operation or maintenance of the Plant.

It is hereby understood that title to any and all property of whatever character, the cost of which is paid by Reserve pursuant to this subsection (b) of this Section 10, shall vest directly in Reserve, and that title to such property shall in no event vest in Operator.

It is further understood that the cost of repairs, if performed in repair shops maintained by Operator, shall include an appropriate charge to reim-

Plaintiff's Exhibit No. 6—(Continued)  
burse Operator for overhead expense incurred by  
Operator in maintaining such repair shops.

It is hereby further understood that in the acquisition, purchase and installation of any machinery, equipment, materials, or supplies in connection with any alterations, improvements or betterments of, or additions to, the Plant, or in connection with any replacements made in the Plant, and in the negotiation, execution and supervision of all contracts with third parties in connection therewith, Operator shall act as Agent for and on behalf of Reserve; provided, however, that as a condition precedent to reimbursement under the terms of this subsection (b) any such expenditure for the acquisition, purchase or installation of machinery, equipment, materials or supplies in connection with any alterations, improvements or betterments of, or additions to, the Plant involving more than One Thousand Dollars (\$1,000) shall be first approved in writing by Reserve; and provided, further, that as a condition precedent to reimbursement under the terms of this said subsection (b), any such expenditure for the acquisition, purchase or installation of machinery, equipment, materials or supplies in connection with any replacement in the Plant involving more than Five Thousand Dollars (\$5,000) shall be first approved in writing by Reserve.

\* \* \* \* \*

(d) The amount of all premiums or other costs of any bonds or insurance, including public liability, employers' liability, property damage, workmen's

## Plaintiff's Exhibit No. 6—(Continued)

compensation, fidelity, fire, theft, burglary or other insurance, which Reserve may specifically require Operator to carry under this contract. In the event Reserve and Operator shall cover workmen's compensation risks on a self-insurance basis, such arrangements shall be effectuated in a manner mutually satisfactory to the parties hereto.

\* \* \* \* \*

(h) The cost of constructing, equipping and operating any pilot plants for the experimental operation of any process or processes used or intended to be used in the production of Synthetic Rubber, including the cost of all materials used or consumed in such experimental operation; provided, however, that such cost shall be included only to the extent approved in advance or ratified in writing by Reserve in accordance with arrangements mutually satisfactory to Reserve and to Operator.

(i) The cost of conducting research, experimental, laboratory and developmental work, including all costs under contracts or subcontracts for technical services or consultant advice; provided, however, that such cost shall be included only to the extent approved in advance or ratified in writing by Reserve in accordance with arrangements mutually satisfactory to Reserve and to Operator.

\* \* \* \* \*

Section 12. It is understood that in the performance of this contract, Operator is acting as Agent for Reserve, for the account and at the expense and risk of the latter, and that, accordingly,

## Plaintiff's Exhibit No. 6—(Continued)

Operator shall in no event be liable for, but shall be held harmless by Reserve against any damage to or loss or destruction of property (whether owned by Reserve or others) or any injury to or death of persons, in any manner, arising out of or in connection with the work hereunder, unless it be shown to have been caused directly by bad faith or wilful misconduct on the part of any officer of Operator or any representative of Operator having supervision and direction of the Plant as a whole or of the Operating Facilities or of the Standby Facilities, acting within the scope of his authority and employment, or unless it results from the failure of Operator to carry such insurance coverage as Operator may be required to carry under this contract. It is further understood that raw materials of the type required for the production of Synthetic Rubber are subject to an element of loss due to shrinkage, spoilage, waste and the like, in the course of storage and processing.

\* \* \* \* \*

## Section 21. \* \* \* \* \*

(e) Any breach or violation of any of the foregoing representations and stipulations shall render the party responsible therefor liable to the United States of America for liquidated damages, in addition to damages for any other breach of this contract, in the sum of Ten Dollars (\$10) per day for each male person under sixteen (16) years of age or each female person under eighteen (18) years of age, or each convict laborer knowingly employed in the

## Plaintiff's Exhibit No. 6—(Continued)

performance of this contract, and a sum equal to the amount of any deductions, rebates, refunds, or underpayment of wages due to any employee engaged in the performance of this contract; and, in addition, the agency of the United States entering into this contract shall have the right to cancel same and to make open-market purchases or enter into other contracts for the completion of the original contract, charging any additional cost to the original contractor. Any sums of money due to the United States of America by reason of any violation of any of the representations and stipulations of this contract as set forth herein may be withheld from any amounts due on this contract or may be recovered in a suit brought in the name of the United States of America by the Attorney General thereof. All sums withheld or recovered as deductions, rebates, refunds, or underpayments of wages shall be held in a special deposit account and shall be paid, on order of the Secretary of Labor, directly to the employees who have been paid less than minimum rates of pay as set forth in such contracts and on whose account such sums were withheld or recovered: Provided, That no claims by employees for such payments shall be entertained unless made within one (1) year from the date of actual notice to Operator of the withholding or recovery of such sums by the United States of America.

\* \* \* \* \*

Section 25. Reserve shall have the right to ter-

## Plaintiff's Exhibit No. 6—(Continued)

minate this contract at any time, upon giving to Operator ten (10) days' written notice of such termination, and in the event of such termination by Reserve, Operator shall be reimbursed by Reserve for all costs, expenses and losses sustained or incurred by Operator in anticipation of performance of this contract and Reserve shall be liable for any loss sustained by Operator on all such obligations, commitments and claims as Operator may have undertaken or incurred in connection therewith as of the date of such termination. Further, in the event Reserve so terminates within one year of the commencement of the term of this contract, Operator shall be entitled to receive from Reserve an amount equal to the fee prescribed by Reserve's Manual of Administrative Procedure for the Labor Supply form of contract based upon an estimate related to the aforesaid reactivation to be mutually agreed upon within thirty (30) days from the date of actual execution of this contract.

Operator shall have the right to terminate this contract during the term hereof upon not less than ninety (90) days' written notice to Reserve.

\* \* \* \* \*

Section 27. Operator shall not sell, assign, or pledge its interests under this contract, nor any of its rights, powers, privileges, duties or obligations hereunder, nor sublease or permit the use by others of any part of the Plant, without the prior written consent of Reserve. Reserve may transfer the Plant and may assign its interest under this contract to

Plaintiff's Exhibit No. 6—(Continued)

any other branch of the Government, and upon such transfer and assignment such other branch of the Government shall acquire all the rights, powers, and privileges of Reserve hereunder and shall be bound by all the duties and obligations of Reserve hereunder, and Reserve shall thereby cease to have any rights, powers, privileges, duties or obligations hereunder, it being expressly understood that any such transfer and assignment by Reserve of its interest in this contract to any other branch of the Government shall be subject to all the rights, powers and privileges of Operator hereunder and shall be conditioned upon such assignee's assuming all duties and obligations of Reserve hereunder.

\* \* \* \* \*

Section 29. The term of this contract, in the absence of and subject to a prior cancellation or termination as hereinabove provided, shall be for a period commencing 12:01 a.m., August 28, 1950 and ending 11:59 p.m., June 30, 1952.

\* \* \* \* \*

Section 31. Reserve agrees that, notwithstanding any other provision of this contract, the summation of all liabilities of Operator arising out of any provision of this contract or any operations conducted thereunder shall in no event exceed the total amount of One Million Dollars (\$1,000,000).

\* \* \* \* \*

(Testimony of John Condrey.)

Mr. Clark: I wish to revert now to your function and performance as secretary of the Pacific Rubber Company, Mr. Condrey. The minute books were in your custody, were they not, from the date of the organization of the Pacific Rubber Company, at all times after that, down to and including the present time? A. In my personal custody?

Q. Yes, as secretary of the corporation they were, were they not? [36]

A. No, they were not in my possession.

Q. Where were they?

A. Well, they were used in the deposition proceedings in connection with this case that were held. They were out of my possession and—

Q. Those were the only occasions when they were out of your possession, Mr. Condrey?

A. Up to the present time?

Q. Yes. From the very organization of the Pacific Rubber Company down to the present time, how many times have the minute books or when were the minute books out of your personal custody as secretary of the corporation?

A. I wouldn't remember specifically.

Q. Were they at all times—

A. Pardon me?

Q. Were they at all times in your office subject to your control?

A. Not at all times in my office.

Q. Well, where were they?

A. Well, they were in the office of the attorneys at which the depositions were conducted. [37]

\* \* \* \* \*

(Testimony of John Condrey.)

Q. Was there a meeting of the Board of Directors held on January 15, 1951 — meeting of the Board of Directors of Pacific Rubber Company?

A. January 15, 1951? [39]

Q. 1951. A. Yes.

Q. Yes. Now, look at the minutes in the book there. Find the minutes there. You don't need to read them. A. No.

Mr. Clark: May I have this marked for identification?

Mr. Dinkelspiel: What is it?

Mr. Clark: I will show it to you in a minute. May I have the instrument marked for identification?

The Court: It may be marked Exhibit 7 for identification.

(Document marked Plaintiff's Exhibit 7 for identification.)

The Witness: What was the question?

Q. (By Mr. Clark): I just asked you to turn to it. A. Oh.

Q. There was a meeting on January 15th, 1951?

A. That is correct.

Q. What was it, regular or special meeting?

A. It was a regular meeting.

Q. All right. We don't need to read the minutes. I will take the minute book in just a moment.

Will you state whether or not that is your signature on that letter? You don't need to read the letter. Is that your signature?

A. That is my signature. [40] \* \* \* \* \*

(Testimony of John Condrey.)

Q. Please examine the letter to which you have attached your signature, letter dated January 26, 1951, being the first instrument in Plaintiff's Exhibit 7 for identification.

Just look at the letter a moment. Have you read it? A. Yes. [41]

Q. Now, examine every instrument under that letter, please, and then I want to ask you a general question.

That is your signature also, isn't it, on the letter dated January 26th?

A. That is my signature.

Q. Yes. The first letter in the file under the clip here, identified as Plaintiff's Exhibit 7 for identification, is addressed to Mr. Glen A. Taylor, Vice President, Robbins Tire & Rubber Company, Inc., Tuscumbia, Alabama, is it not? A. Yes.

Q. The second letter is addressed on the same date to Robbins Tire & Rubber Company, Tuscumbia, Alabama, attention Mr. Poncet Davis, President, is that correct?

A. That is correct.

Q. Now, you enclosed with this first letter addressed to Glen A. Taylor certain documents of waiver and consent, an original and one copy, didn't you? A. Yes.

Q. A copy of the minutes? A. Yes.

Q. Did you make a copy of the minutes?

A. Yes.

Q. You knew when you enclosed the copy that it was a correct copy, didn't you?

(Testimony of John Condrey.)

A. When I enclosed it? [42]

\* \* \* \*

Mr. Clark: May I have the last question read, if your Honor please?

The Court: Yes.

(Thereupon the Reporter read: "Q. You knew when you enclosed the copy that it was a correct copy, didn't you?"")

A. That is right.

Q. (By Mr. Clark): That it was a correct copy that you enclosed, and you also enclosed a certified copy of a resolution and that was a correct copy?

A. That is correct.

Q. All right. And this certified copy of the resolution, this thing marked at the top, the last document in the file, marked Plaintiff's Exhibit 7, entitled "Certified Copy of Resolution of Board of Directors, Pacific Tire & Rubber [43] Company," is also a correct copy? A. It is.

Mr. Clark: I offer these in evidence, if your Honor please.

Mr. Dinkelspiel: Your Honor please, we object to the introduction as incompetent, irrelevant and immaterial; as insufficient foundation; not within the issues of this case.

Before pursuing my objection further, I would like to ask Mr. Clark one question, if I may have the exhibit, and I think it's a fair question to ask of counsel.

Attached as part of this group of documents is, first, a letter to Mr. Glen Taylor referring to,

(Testimony of John Condrey.)

among other things, a waiver and consent to the holding of the meeting.

Attached, too, as a part of this exhibit, is what appears to be such a consent on what is usually the stationery of a minute book, which I am sure will fit in this minute book, and I am going to ask Mr. Clark how he got this.

Mr. Clark: We certainly didn't steal it out of the minute book.

Mr. Dinkelspiel: No, but where did it come from? I am not suggesting that you stole it.

Mr. Clark: It came from Mr. Taylor's files.

Mr. Dinkelspiel: From Mr. Taylor's files?

Mr. Clark: Yes. [44]

\* \* \* \*

The Court: Well, for the moment I will admit them. They are actions by the Secretary of the corporation, I take it. I haven't looked at them. [45]

PLAINTIFF'S EXHIBIT No. 7-A

## Pacific Tire & Rubber Company

## Factory and General Offices

4901 East 12th Street

Oakland 1, California

January 26, 1951

Mr. Glenn A. Taylor, Vice President

## Robbins Tire and Rubber Co., Inc.

## Tuscumbia, Alabama

Dear Glenn:

To satisfy a technical requirement of the depositary bank it is necessary that they be furnished with a Certified Copy of Resolution of Board of

Directors of Pacific Rubber Company authorizing endorsement of checks and drafts made payable to Pacific Rubber Company, so that they may properly be deposited into the account of "C. L. Cameron, Trustee for John B. Condrey and Robbins Tire and Rubber Company, Incorporated."

To comply therewith it was necessary that a Directors Meeting be held on January 15, 1951. Enclosed are the following documents appertaining thereto:

Waiver and Consent (original and copy)

Minutes (copy)

Certified Copy of Resolution (copy)

Your signing and returning the original Waiver and Consent will be appreciated. Copies of all documents are to be retained for your file.

It certainly was a pleasure to meet you during the few hours you were here January fifth. It is unfortunate that everyone was so busy and the time was so short that it was impossible for you to become personally acquainted with several other members of the Pacific organization. However, we all hope you may be able to visit us again.

Best personal regards,

/s/ JOHN B. CONDREY.

JBC/lp

Enes.

Airmail

PLAINTIFF'S EXHIBIT No. 7-B

Waiver and Consent to the Holding of a Special  
Meeting of the Board of Directors of Pacific  
Rubber Company

We, the undersigned, being all of the directors of Pacific Rubber Company, a California Corporation, desiring to hold a special meeting of the Board of Directors of said corporation on January 15, 1951 at the hour of 10:00 o'clock A.M. for the purpose of adopting a resolution authorizing the deposit of accounts receivable funds of this corporation with American Trust Company, Fruitvale Branch, Oakland, California, do hereby waive notice of said meeting at Oakland, California on the 15th day of January, 1951 at 10:00 o'clock A.M. for the purpose as above set forth and for the purpose of conducting any other business which may come before the said meeting, and further agree that any business transacted at said meeting shall be as valid and legal and of the same force and effect as though said meeting were held after notice duly given.

Witness our signatures this 14th day of January, 1951.

/s/ W. H. DeSellem

/s/ Glenn A. Taylor

/s/ John Condrey

## PLAINTIFF'S EXHIBIT No. 7-C

Waiver and Consent to the Holding of a Special  
Meeting of the Board of Directors of Pacific  
Rubber Company

We, the undersigned, being all of the directors of Pacific Rubber Company, a California Corporation, desiring to hold a special meeting of the Board of Directors of said corporation on January 15, 1951 at the hour of 10:00 o'clock A.M. for the purpose of adopting a resolution authorizing the deposit of accounts receivable funds of this corporation with American Trust Company, Fruitvale Branch, Oakland, California, do hereby waive notice of said meeting at Oakland, California on the 15th day of January, 1951 at 10:00 o'clock A.M. for the purpose as above set forth and for the purpose of conducting any other business which may come before the said meeting, and further agree that any business transacted at said meeting shall be as valid and legal and of the same force and effect as though said meeting were held after notice duly given.

Witness our signatures this 14th day of January,  
1951.

/s/ W. H. DeSellem  
/s/ Glenn A. Taylor  
/s/ John Condrey

## PLAINTIFF'S EXHIBIT No. 7-D-E

Minutes of Special Meeting of Board of Directors  
of Pacific Rubber Company

Pursuant to the foregoing Waiver and Consent, a Special meeting of the Board of Directors was held on the 15th day of January 1951, at the hour of 10:00 o'clock A.M. in the office of Pacific Tire & Rubber Company, located at 4901 East 12th Street, Oakland, California.

Wesley H. DeSellem, Vice President of the Corporation, acted as Chairman of the Meeting, and John B. Condrey, acted as Secretary.

The Chairman called the meeting to order and instructed the Secretary to call the roll. Present were Wesley H. DeSellem and John B. Condrey. G. A. Taylor was absent.

The Chairman then announced that the meeting was held for the purpose of adopting a resolution authorizing the deposit of accounts receivable funds of this corporation into the account established at American Trust Company, Fruitvale Branch, Oakland, California in the name of C. L. Cameron, Trustee for John B. Condrey and Robbins Tire and Rubber Company, Incorporated. Upon motion duly made, seconded and unanimously carried the following resolution was adopted:

"Whereas, this corporation filed its Certificate to Wind Up and Dissolve its Affairs with the Secretary of the State of California on January 10, 1951; and

"Whereas, the company proposes to transfer all

of its assets by way of liquidation to its shareholders, namely John B. Condrey and Robbins Tire and Rubber Company, Incorporated; and

"Whereas, John B. Condrey and Robbins Tire and Rubber Company have appointed C. L. Cameron as their Trustee to receive money for their account and to disburse the same in liquidation of Pacific Rubber Company's accounts payable; and

"Whereas, this company will receive from time to time a great number of checks and drafts as accounts receivable of this company; and

"Whereas, this company desires to deposit said checks and drafts to the account of C. L. Cameron, Trustee for John B. Condrey and Robbins Tire and Rubber Company, Incorporated;

"Now Therefore, Be It Resolved, that any two officers of this company be and they are hereby authorized to endorse all checks and drafts made payable to this company to the order of C. L. Cameron, Trustee for John B. Condrey and Robbins Tire and Rubber Company, Incorporated.

"Be It Further Resolved, that the Secretary of this corporation be and he is hereby authorized to deliver a certified copy of this resolution to the American Trust Company, Fruitvale Branch, Oakland, California."

There being no further business to come before this meeting, upon motion duly made, seconded and unanimously carried, the meeting was adjourned.

/s/ W. H. DeSellem,

Chairman.

/s/ John Condrey,

Secretary.

## PLAINTIFF'S EXHIBIT No. 7-F-G

Certified Copy of Resolution of Board of Directors  
of Pacific Rubber Company

At a special meeting of the Board of Directors of Pacific Rubber Company, duly convened at 4901 East 12th Street, Oakland, California, on the 15th day of January, 1951, at the hour of 10 o'clock A.M., the following resolution was adopted:

"Whereas, this corporation filed its Certificate to Wind Up and Dissolve its Affairs with the Secretary of State of the State of California on January 10, 1951; and

"Whereas, the company proposes to transfer all of its assets by way of liquidation to its shareholders, namely John B. Condrey and Robbins Tire and Rubber Company, Incorporated; and

"Whereas, John B. Condrey and Robbins Tire and Rubber Company have appointed C. L. Cameron as their Trustee to receive money for their account and to disburse the same in liquidation of Pacific Rubber Company's accounts payable; and

"Whereas, this company will receive from time to time a great number of checks and drafts as accounts receivable of this company; and

"Whereas, this company desires to deposit said checks and drafts to the account of C. L. Cameron, Trustee for John B. Condrey and Robbins Tire and Rubber Company, Incorporated;

"Now Therefore, Be It Resolved, that any two officers of this company be and they are hereby authorized to endorse all checks and drafts made pay-

able to this company to the order of C. L. Cameron,  
Trustee for John B. Condrey and Robbins Tire and  
Rubber Company, Incorporated.

"Be It Further Resolved, that the Secretary of  
this corporation be and he is hereby authorized to  
deliver a certified copy of this resolution to the  
American Trust Company, Fruitvale Branch, Oak-  
land, California."

The undersigned Secretary of Pacific Rubber  
Company hereby certifies that the foregoing is a  
full, true and correct copy of the resolution of the  
Board of Directors, adopted by the Board at a  
meeting of said Board of Directors held on the  
date, time and place above specified and said reso-  
lution has not been modified or rescinded.

In Witness Whereof, I have hereto set my hand  
and the corporate seal of the corporation this 15th  
day of January, 1951.

/s/ John Condrey,  
Secretary.

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PLAINTIFF'S EXHIBIT No. 7-H

Pacific Tire & Rubber Company

Factory and General Offices

4901 East 12th Street      Oakland 1, California

January 26, 1951

Robbins Tire and Rubber Company, Inc.

Fuscumbia, Alabama

Attention: Mr. Poncet Davis, President

Gentlemen:

In compliance with paragraph 11 of the Agree-

ment dated January 7, 1951 between Edwin W. Pauley, Poncelet Davis, Trustee, and Inland Rubber Corporation, Parties of the First Part, and John B. Condrey and Robbins Tire and Rubber Company, Incorporated, Parties of the Second Part, enclosed herewith is duplicate original certified copy of resolution called for in said paragraph, to be executed and delivered by Pacific Tire & Rubber Company to Robbins Tire and Rubber Company, Incorporated.

The aforementioned paragraph recites:

"On the Closing Date the Corporation shall accept this agreement and deliver to Sellers a certified copy of the resolution of its Board of Directors, authorizing this agreement. Thereupon the Corporation shall become and be a party to this Agreement."

Yours very truly,

Pacific Tire & Rubber Company

/s/ John B. Condrey,

Secretary.

JBC/lp

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PLAINTIFF'S EXHIBIT No. 7-I

Certified Copy of Resolution of Board of Directors  
of Pacific Tire & Rubber Company

At a special meeting of the Board of Directors of Pacific Tire & Rubber Company, duly convened in Suite 808 of the St. Francis Hotel, Powell and Geary Streets, San Francisco, California, on the 15th day of January, 1951, at the hour of 4:30

o'clock P.M., the following resolution was adopted:

"Whereas, on January 7, 1951, Edwin W. Pauley, Poncet Davis, Trustee for Poncet Davis, Jr. and Katharine "Trinka" Davis, and Inland Rubber Corporation, as First Parties, and John B. Condrey and Robbins Tire and Rubber Company, as Second Parties, entered into an agreement whereby First Parties agreed to form a corporation to purchase certain assets of Pacific Rubber Company; and

"Whereas, Second Parties, as the sole stockholders of Pacific Rubber Company, agreed to liquidate Pacific Rubber Company and to sell and dispose of certain of its assets to the new company to be formed; and

"Whereas, the new company to be formed, when formed, agreed to purchase said assets therein enumerated; and

"Whereas, this corporation is the corporation contemplated under the terms of said agreement;

"Now Therefore, Be It Resolved, that the Vice President and Secretary of this corporation be and they are hereby authorized to execute said agreement of January 7, 1951, for and on behalf and in the name of this corporation.

"Be It Further Resolved, that the Secretary of this corporation be and he is hereby authorized to prepare and deliver to John B. Condrey, Robbins Tire and Rubber Company, Incorporated, and to such other persons as may be entitled to a copy thereof, a certified copy of this resolution."

The undersigned Secretary of Pacific Tire & Rubber Company hereby certifies that the foregoing

is a full, true and correct copy of the resolution of the Board of Directors adopted by the Board at a meeting of said Board of Directors held on the date, time and place above specified and said resolution has not been modified or rescinded.

In Witness Whereof, I have hereto set my hand and the corporate seal of the corporation this 15th day of January, 1951.

[Seal] /s/ John B. Condrey,  
Secretary.

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\* \* \* \* \*

Q. (By Mr. Clark): Now, isn't this form of waiver to Mr. Taylor with that letter of January 26, 1951? A. That is right.

Q. And you also sent him a copy of what is purported to be the action taken by the corporation at the meeting, notice of which you wished him to waive subsequently on the minute book; is that correct? A. That is correct.

Q. All right. Now, the waiver says that it is a waiver and consent to the holding of a special meeting of the board of directors of the Pacific Rubber Company. I have read that correctly, isn't that right? A. I believe you have.

Q. Is there any doubt in your mind? You say you believe I have. [47]

\* \* \* \* \*

Q. (By Mr. Clark): Waiver for a special meeting, wasn't it? Waiver of notice for a special meeting? A. That's correct.

Q. All right. Now, would you look at the min-

(Testimony of John Condrey.)

utes of the meeting of January 15th as they appear in the minute book, which you say is correct, and tell us whether the meeting of January 15th, was regular or special, according to the minute book?

A. According to the minute book, it was regular.

\* \* \* \* \*

Q. (By Mr. Clark): And the minute book is correct, is that right? [48] A. It is.

Q. Why did you send Mr. Taylor a waiver of a special meeting, notice of a special meeting, then?

A. I couldn't answer that question because I don't remember.

Q. You don't remember why you did it?

A. No.

Q. Well, are they both correct? Is it a waiver of notice for a special meeting? [49]

\* \* \* \* \*

Q. (By Mr. Clark): Do you know the difference between a regular and a special meeting of the board of directors of a corporation? I don't want to confuse you. That's the reason I ask you the question. A. I believe I do.

Q. Well, would you mind stating your knowledge of it?

A. Well, a regular meeting would be a meeting that was provided for in either the bylaws or by resolution of the board of directors, on a certain specific date, wherein a certain specific date was set for taking up affairs of the corporation.

A special meeting would be a meeting that would

(Testimony of John Condrey.)

have to be called of necessity at some other time to perform some other necessary act that could not wait or could not be held over until the regular meeting date. [50]

Q. Well, let me see if I can clarify that, and you tell me if this conforms to your understanding:

A regular meeting of a board of directors is a meeting for which generally no notice need be given to the members of the board. A special meeting is a meeting for which notice must be given.

Mr. Dinkelspiel: I object to that.

Q. (By Mr. Clark): Is that your understanding?

Mr. Dinkelspiel: He has already answered the question.

Mr. Clark: I think he has answered it in exactly that way, but I wanted to shorten it a little.

A. (By the Witness): If it were provided in the bylaws and a meeting of the board of directors that no notice be given, that is my understanding, that it would be without notice. \* \* \* \* \* [51]

Q. Do you know whose handwriting that is above the word "Special" in what purports to be a certified copy of Resolution of the Board of Directors of Pacific Rubber Company?

A. No, I do not. I do not know.

Q. Has this minute book, with the exception of the times that it has been in the hands of Counsel who were taking a [53] deposition, been in Oakland in the office of the Pacific Tire & Rubber Company or Pacific Rubber Company, one or the other,

(Testimony of John Condrey.)

always? A. (No response.)

Q. Has it ever been in Los Angeles?

A. I don't know whether, to my knowledge whether it has been in Los Angeles.

Q. Well, who has the custody of it?

A. I have.

Q. Did you ever send it to Los Angeles?

A. My recollection—to my best recollection, I can't ever remember sending that to Los Angeles.

Q. Did you ever permit anybody to take it to Los Angeles? A. Not to my knowledge.

Q. What do you mean, not to your knowledge or not to your recollection?

A. I would like to answer the question.

Q. Go ahead.

A. That minute book along with other exhibits which I was required to bring into this court by service upon me, why, along with other information that pertained to this case was turned over to my Counsel.

Q. I understand that, of course.

A. And to my knowledge they had no reason to take it to Los Angeles, but I do not know that.

Q. You mean turned over for the purpose of this case? A. Yes, that's right.

Q. Apart from that. I am not raising any question of what your counsel did.

A. If that will answer your question, that's it.

Q. You never permitted anybody other than a lawyer to take the minute book to Los Angeles?

A. No.

(Testimony of John Condrey.)

Q. Do you recollect that you ever permitted any lawyer to take the minute book to Los Angeles?

A. Not to my knowledge. Not under my instructions.

Q. Not to your recollection, is that what you mean? A. Not to my recollection.

Q. If it was done, you had no knowledge of it or present recollection?

A. That's right. [55]

\* \* \* \* \*

Q. Where is the minute book containing those minutes? Is it in the back?

A. Well, these run up—

Q. Oh, I see.

A. That is this minute book I am talking about. Now, there was a period on or about the early part of January, 1951, that that book could have been in Los Angeles at the time of the formation of the new corporation and new partnership.

Q. Yes?

A. And it would have been in Los Angeles at that time.

Q. Can you find the minutes of the organization meeting of that board of directors?

A. The organization meeting prior to my becoming a director?

Q. Yes. Can you find them in here?

A. Yes.

Q. First meeting of the board of directors, is that it? A. Yes, that is correct.

Q. Can you find in the minute book any place

(Testimony of John Condrey.)

where regular meetings are authorized to be held?  
Maybe that will shorten it.

Mr. Dinkelspiel: Will you take my assistance on that, Mr. Clark?

Mr. Clark: Yes. Was that done at the first meeting? [56]

Mr. Dinkelspiel: Well, there is a by-law on the subject, and then there was an authorization and then there was a resolution.

Mr. Clark: The by-laws don't show it.

Mr. Dinkelspiel: Let's get the by-laws.

Mr. Clark: Well, let's get the minutes first. I would like to have this my way.

Mr. Dinkelspiel: The minutes of the 29th day of December, 1948, Mr. Clark.

Mr. Clark: Now, if your Honor please, I should like to offer and I do offer in evidence—I don't want to offer this original, but may we have it understood that we can—

Mr. Hedges: We will furnish a photostatic copy.

Mr. Clark: Photostatic copy of the first meeting of the Board of Directors of Pacific Rubber Company.

Mr. Hedges: Mr. Dinkelspiel has it in his hand there.

Mr. Clark: May we offer it in evidence?

Mr. Dinkelspiel: Yes. We have no objection.

The Court: That is the minutes of the first meeting—

Mr. Clark: Of Pacific Rubber Company. Min-

(Testimony of John Condrey.)

utes showing it was held on the 29th of December, 1948, at ten o'clock.

The Court: It may be admitted and marked Exhibit 8.

(Minutes admitted in evidence and marked Plaintiff's Exhibit 8.) [57]

\* \* \* \* \*

Mr. Clark: Is that the only place in the minutes of Pacific Rubber Company where there is authorization for regular meetings?

Mr. Dinkelspiel: That's the only place in the minutes [58] of Pacific Rubber Company so authorizing. But I also would like to have in the evidence the Article 3, Section 5, of the By-Laws that may be the basis for this authorization.

Mr. Clark: I have no objection to that and will offer them myself, if your Honor please.

Mr. Dinkelspiel: If you would like to offer them, they are here. The by-laws are here.

Mr. Clark: These are the entire by-laws?

Mr. Hedges: That is right.

Mr. Clark: All right.

We wish to put that in, if your Honor please, the by-laws as a whole. [59]

\* \* \* \* \*

(Agreement admitted in evidence as Plaintiff's Exhibit 12.) [60]

[Printer's Note: Exhibit 12 is a duplicate of Exhibit A attached to Answer of Bay Rubber Co. at pages 48-51.]

\* \* \* \* \*

(Copy of agreement marked Plaintiff's Exhibit 13 and received in evidence.)

[Printer's Note: Exhibit 13 is a duplicate of Exhibit B attached to the Answer of the Bay Rubber Company at pages 51-60.]

\* \* \* \* \*

### PLAINTIFF'S EXHIBIT No. 14

January 15, 1951.

Mr. C. L. Cameron

717 North Highland Avenue

Los Angeles 38, California

Dear Sir:

We hereby appoint you to act as our Agent to collect and receive all payments due us from the Pacific Tire & Rubber Company under the terms of that certain Agreement dated January 7, 1951.

Upon receipt of such funds, you are authorized to deposit them in a Bank Account to be opened by you in the American Trust Company. [J. C. and G. B.]\* The Bank Account shall be established in the name of C. L. Cameron, Trustee for John B. Condrey and Robbins Tire and Rubber Company, Incorporated.

From the funds so received by you for our account, you are authorized to liquidate, as quickly and expediently as possible, all Bank Loans, Accounts Payable and other indebtedness of Pacific Rubber Company, of which we are the sole stockholders.

---

\*[Words in Brackets are struck out in copy and initialed J. C. and G. B.]

The balance remaining in your hands after the payment of all accounts shall be distributed to us as follows: 58.597% to John Condrey, 41.403% to Robbins Tire and Rubber Company, Incorporated.

In case of your death, or other legal disability, while this Agreement is in effect, the American Trust Company shall be substituted in your place.

This Agreement shall constitute an Agency coupled with an interest and shall be irrevocable.

Delivery of a duplicate-original of this letter to Pacific Tire & Rubber Company will be their authority to make the payments contemplated under the Agreement of January 7, 1951, directly to you.

Very truly yours,

/s/ JOHN CONDREY

[Seal] ROBBINS TIRE AND RUBBER  
COMPANY, INCORPORATED

/s/ By GEORGE BOUCHARD,  
Authorized Agent.

Accepted:

/s/ C. L. CAMERON

\* \* \* \* \*

Q. Will you turn to the minutes of any other meeting of the board of directors that was held on that date, January 15th, 1951? You opened it at a page here entitled "Minutes of Regular Meeting of Board of Directors of Pacific Rubber Company," the first paragraph of which reads—this, Your Honor, is merely to identify the page that begins the minutes.

(Testimony of John Condrey.)

"The regular meeting of the board of directors of Pacific Rubber Company was held on the 15th day of January, 1951, at the hour of 10:30 o'clock a.m. in the offices of the corporation located at 4901 East 12th Street, Oakland, California." There were two directors present at that meeting.

Is that correct? A. That's correct. [65]

Q. Wesley H. DeSellem, who acted as chairman of the meeting, and John Condrey, yourself, secretary? A. Right.

Q. You were present, of course?

A. That's right.

Q. And so was DeSellem? A. That's right.

\* \* \* \* \*

Q. (By Mr. Clark): The minutes of another meeting on January 15th, 1951 which you have shown me, which you show me, are entitled "Minutes of Regular Meeting of Board of [66] Directors, Pacific Rubber Company," the first paragraph reads:

"A regular meeting of the board of directors of Pacific Rubber Company was held on the 15th day of January, 1951, at the hour of 10:00 o'clock a.m. in the office of Pacific Tire & Rubber Company, located at 4901 East 12th Street, Oakland, California."

Now, those were the only meeeting of the board of the directors that were held on January 15th, 1951? A. I believe they were.

Q. Go ahead. A. That is not correct.

Q. What is that?

(Testimony of John Condrey.)

A. No, that is not correct.

Q. Were there more than two meetings of the board of directors held on January 15th, 1951?

A. No. That is correct; there were just two meeting. They were 10:00 and 10:30.

Q. All right. Let's get that clear in the record. There were only two meeting of the board of directors of Pacific Rubber Company held on January 15th, 1951, one according to the minutes, at 10:00 o'clock and the other, according to the minutes, at 10:30 in the morning; is that right?

A. That's correct.

Q. All right. Will you examine the last paragraph of the minutes of the meeting of that date which are said to have [67] in the minutes in the first paragraph to have been held at 10:00 o'clock a.m. Examine the last paragraph.

A. 10:00 o'clock a.m.?

Q. That paragraph reads as follows, does it not—I quote:

"There being no further business to come before this meeting upon motion duly made, seconded and unanimously carried, the meeting was adjourned."

A. That is correct.

Q. Now, is the meeting relating to which you sent to Taylor a proposed waiver of notice, is it not, or am I wrong about that?

Mr. Dinkelspiel: Show him Exhibit 7. That is the one which you had reference to.

A. I believe that I would have to look and see what I did say.

(Testimony of John Condrey.)

Q. (By Mr. Clark): All right. I don't know if I have that right or not, but you can check me on it. I show the witness Exhibit 7, if the Court please. A. That is right.

Q. Then did the board of directors, according to the minutes hold another meeting at 10:30 on that day? The minutes do show, do they not?

A. That is correct.

Q. Did you give anybody any notice of the meeting which was held at 10:30 on January 15th, 1951, or was it a regular [68] meeting?

A. It was a regular meeting.

Q. So the minutes state, don't they?

A. That's correct.

Q. And the minutes of the meeting which was held at 10:00 o'clock on that date also state that that was a regular meeting, do they not?

A. They do. [69]

\* \* \* \* \*

Q. (By Mr. Clark): Will you turn, please, to the minutes of the meeting of May 18th, 1951, Mr. Condrey. Do you have them before you? [77]

A. I do.

Q. How many members of the Board of Directors of Pacific Rubber Company were present at that meeting? [78]

\* \* \* \* \*

The Court: The question was how many members were present.

Q. (By Mr. Clark): How many members of the Board, yes.

(Testimony of John Condrey.)

The Court: He may answer.

The Witness: There was one member of the Board of Directors. [79]

\* \* \* \* \*

Q. (By Mr. Clark): Now, will you turn, please, to the minutes of the meeting of the Board of Directors of Pacific Rubber Company which was held on the 21st of May of 1951 at ten o'clock in the morning at the company offices in Oakland?

A. Yes. [80]

Q. You were present at that meeting?

A. I was.

Q. Who else was present?

A. W. H. DeSellem.

Q. Any other member of the board of directors?

A. No.

Q. Anybody else other than the two members of the board of directors? A. No one else.

Q. No one else? Was there any notice of that meeting given by you as secretary? A. No.

Q. You said, I think, you were a stockholder of Pacific Rubber Company, is that correct?

A. I was.

Q. You said that this morning, I believe.

A. I did.

Q. DeSellem was not a stockholder of Pacific Rubber Company? A. He was not.

Q. You also became a member of the limited co-partnership called Bay Rubber Company, did you not? A. I did. One per cent co-partner.

Q. But you were a member of that partnership?

(Testimony of John Condrey.)

A. Yes.

Q. Do you know whether or not Pacific Rubber Company, [81] through its directors, it being then in liquidation, sold or assigned the Minnesota Mining Company contracts to Bay Rubber Company?

A. They did.

Q. They did? Do you know for what consideration? A. For \$5,000.

Q. Do you know how much had accrued to Bay Rubber Company on those contracts in money up to May 21st, 1951? A. I do not.

Q. To Pacific Rubber Company, I mean, not Bay Rubber Company. A. I do not.

Q. You do not? It was more than \$5,000, wasn't it? A. I believe it was.

Q. It was over \$100,000, wasn't it?

A. Could have been. I don't know. [82]

\* \* \* \* \*

Q. Did you ever see any figures showing how much was owing or had accrued to Pacific Rubber Company on the Minnesota Mining & Manufacturing Company contracts up to May 21st, 1951?

A. I never saw the figures.

Q. You didn't know, then, how much had accrued, is that right?

A. That is what I stated.

Q. That is your statement now? A. What?

Q. That is your statement now?

A. That is my statement. [83]

\* \* \* \* \*

(Testimony of John Condrey.)

The Court: The question is, are you related to Edwin W. Pauley?

Q. (By Mr. Clark): By marriage?

A. I am. [90]

\* \* \* \* \*

Q. (By Mr. Clark): Was DeSellem present at that meeting of May 21st?      A. He was. [92]

\* \* \* \* \*

(Whereupon, the above referred to document was identified as Plaintiff's Exhibit 22 and admitted into evidence.)

\* \* \* \* \*

### PLAINTIFF'S EXHIBIT No. 22

January 13, 1951

Pacific Rubber Company  
4901 East 12th Street  
Oakland 1, California

Gentlemen:

By an agreement dated January 7, 1951, Robbins Tire and Rubber Company, Incorporated, and John B. Condrey, have agreed to wind up and dissolve your Company to the extent necessary and to sell most of your assets to a corporation to be formed by Inland and Bay under the name of Pacific Tire & Rubber Company, hereinafter referred to as "Pacific."

Specifically excluded from the assets to be acquired by Pacific are two agreements relating to your participation with Minnesota Mining and Manufacturing Company in the operation of the

Rubber Reserve Synthetic Plant at Torrance, California. Those two agreements are one dated August 28, 1950, between Reconstruction Finance Corporation, Pacific Rubber Company and Minnesota Mining and Manufacturing Company, and the other dated September 20, 1950, between Minnesota Mining and Manufacturing Company and Pacific Rubber Company.

The undersigned agree that if it now is, or hereafter becomes, necessary for an operating tire and rubber company to be associated with Pacific Rubber and Minnesota Mining, in connection with the synthetic rubber project covered by the two contracts mentioned above, then at such time as Pacific is requested by you to do so, it will, to the extent necessary, become associated with you in that project. In such event Pacific shall be paid all of its costs and expenses which result from its being associated with that project. However, Pacific is not to receive any part of the fees or profits accruing to you or Minnesota Mining in connection with such project.

Neither Inland Rubber Corporation nor Pacific shall, without your consent, become affiliated with any other governmental synthetic rubber project so long as you continue to be one of the parties participating in the operation of the Torrance Synthetic Rubber Plant.

You agree by your acceptance of this letter that Pacific shall be entitled to any benefits, such as allocation of rubber, if any, prompt deliveries, or credit in connection with rubber purchases which

may be available to the operating tire and rubber company affiliated with the synthetic rubber project to the extent that you are able to make the same available to Pacific. It is expressly understood that the benefits to which Pacific shall be entitled do not include any patent or other rights which may accrue to you in connection with the synthetic rubber project.

Very truly yours,

INLAND RUBBER CORPORATION,  
a Corporation.

/s/ By EZRA K. BRYAN  
President.

BAY RUBBER COMPANY,  
a Limited Co-Partnership.

/s/ By EDWIN W. PAULEY,  
General Partner.

Accepted this 15th day of January, 1951.

/s/ JOHN B. CONDREY  
ROBBINS TIRE AND RUBBER  
COMPANY, INCORPORATED

/s/ By GEORGE BOUCHARD  
Authorized Agent

Approved and agreed to this 15th day of January, 1951.

PACIFIC TIRE & RUBBER  
COMPANY

/s/ By E. W. BOOZ  
Vice-President

\* \* \* \* \*

(Testimony of John Condrey.)

Q. (By Mr. Clark): I hand you Exhibit No. 22, really a photostatic copy of it, Mr. Condrey for convenience, and ask you to examine the signature John B. Condrey on the second page and state whether or not that is your signature? It's been conceded that it is but I want you to state that it is your signature, a photostatic copy?

A. Correct.

Q. On what date did you sign that instrument?

A. The 15th day of January, 1951.

Q. On May 21st, 1951, at the meeting of the Board of Directors of Pacific Rubber Company on that date did you tell, yourself, who was the other director present, that you had an interest [104] in Bay Rubber Company?

A. I don't know whether I did or not, whether it was discussed at that meeting.

Q. What authority, if any, was there for not giving Glen Taylor, the third Director of Pacific Rubber Company, notice of the meeting of May 21st, 1951?

Mr. Dinkelspiel: I object to the question as calling for the opinion and conclusion of the witness.

Mr. Clark: He was the Secretary of the corporation.

Mr. Dinkelspiel: It has already been introduced in evidence, the fact that this was a regular meeting, what the By-Laws mean by a regular meeting, and that has been answered.

(Testimony of John Condrey.)

The Court: I think this calls for his conclusion, sustained.

Q. (By Mr. Clark): You didn't give him notice, did you? A. To what?

Q. Of the meeting of May 21st, 1951?

A. No, I did not.

Q. Why?

Mr. Dinkelspiel: I object to the question, it's incompetent, irrelevant and immaterial.

The Court: He may answer.

Q. (By Mr. Clark): Why didn't you give him notice that that meeting was to be held? [105]

A. Because it was a regular meeting and it was not necessary to give him notice.

Q. Did anybody tell you to sell the Minnesota Mining contract or assign them to Bay Rubber Company for a consideration of \$5,000, or did you make up your own mind about the price at which to sell the Pacific Rubber Company's interest to Bay Rubber for \$5,000?

A. I made up my own mind. [106]

\* \* \* \* \*

#### Cross Examination

Q. (By Mr. Dinkelspiel): I show you, Mr. Condrey, Plaintiff's Exhibit No. 7, which is a letter sent by you dated January 26th, 1951, to Mr. Glen A. Taylor, Vice-President, and to which is attached or are attached several documents. I will ask you to refer to the second document in order here which is entitled, "Waiver and consent to the holding of a special meeting of the Board of Director, Pacific

(Testimony of John Condrey.)

Rubber Company, dated, the 14th day of January, 1951," and ask you if that is your signature attached to it? A. It is. [110]

Q. And is there also the signature, if you know, of Mr. DeSellem? A. It is.

Q. And it has another signature on it, whose signature is that? A. Glen A. Taylor.

Q. Was that document ever returned to you as the corporate officer of Pacific Rubber Company or any other place? A. Never.

Q. And when did you first see it?

A. Today in court. [111]

\* \* \* \* \*

(Exhibits previously marked Plaintiff's Exhibits 24 and 25 in evidence re-marked Exhibit 24 and 24-A in evidence.) [125]

\* \* \* \* \*

#### PLAINTIFF'S EXHIBIT No. 24

##### Agreement

This Agreement, made and entered into as of the 29th day of June, 1951, by and between Midland Rubber Corporation, a corporation organized under the laws of the State of Illinois, (hereinafter referred to as "Midland"), and Bay Rubber Company, a limited co-partnership, organized under the laws of the State of California (hereinafter referred to as "Bay");

Witnesseth:

Whereas, as of the 28th day of August, 1950 Minnesota Mining and Manufacturing Company and

Pacific Rubber Company entered into a Lease and Operating Agreement, (hereinafter called "Operating Contract"), with the Reconstruction Finance Corporation, (hereinafter referred to as "Reserve"), to lease and operate Reserve's Synthetic Rubber Plant in Torrance, California; and

Whereas, said Operating Contract provides for the participation by Pacific Rubber Company in the performance thereof; and

Whereas, Pacific Rubber Company on January 10, 1951, filed with the Secretary of State of the State of California its Certificate of Election to Wind up and Dissolve its Affairs; and

Whereas, on the 21st day of May, 1951, Pacific Rubber Company assigned all of its right, title and interest in and to said Operating Contract to Bay (retroactively to January 15, 1951); and

Whereas, on the 29th day of June, 1951, Minnesota Mining and Manufacturing Company assigned all of its right, title and interest in and to said Operating Contract to Midland; and

Whereas, Midland and Bay assumed all of the obligations, rights and duties of their respective assignors thereunder; and

Whereas, said Operating Contract provides for the participation by Pacific Rubber Company in the performance thereof, and Minnesota Mining and Manufacturing Company and Pacific Rubber Company heretofore and on September 20, 1950 entered into an Agreement in writing, (referred to as the M-P Operating Agreement), setting forth their respective rights and duties with respect to the per-

formance of said operations and division of compensation received in respect thereto; and

Whereas, said M-P Operating Agreement has been cancelled and terminated by mutual agreement between Midland and Bay; and

Whereas, the parties hereto desire to enter into a new Agreement covering their rights, duties and privileges under said "Operating Contract";

Now, Therefore, in consideration of the promises and the mutual covenants herein contained, it is agreed by and between Midland and Bay as follows:

Section 1. A true and correct copy of the said Operating Contract is hereto attached, marked "Schedule A", and made a part of this contract as though fully set out herein, including specifically but without limitation to generality, the definitions of terms set forth therein.

Section 2. Bay shall assist Midland in obtaining certain chemists, engineers and other personnel for full or part-time employment by Midland in the performance of said Operating Contract. It is contemplated that in connection with the Operating Contract a pilot plant may be established and operated by Midland for the purpose of improving the quality of Synthetic Rubber, establishing lower production costs and to develop new Synthetic Rubbers. Midland and Bay, when and as necessary and desirable, shall furnish personnel for full or part-time employment by Midland in operating said pilot plant or to serve upon a technical committee to be appointed by Midland to advise in the operations of said pilot plant. Bay shall assist Midland

and/or Reserve in obtaining raw materials for the manufacture of synthetic rubber under said Operating Contract and shall assist in preparing a study of the postwar needs and uses of synthetic rubber products on the Pacific Coast.

Section 3. Midland shall maintain a complete separate system of accounts for the work under the said Operating Contract. All accounting records pertaining to the performance of said Operating Contract with Reserve shall be subject to inspection and audit during business hours by any authorized representative of Bay, but all information obtained therefrom shall be held in confidence.

Section 4. Subject to the provisions of Sections 5 and 6, Midland shall pay to Bay upon receipt thereof from Reserve, thirty-five percent (35%) of the net proceeds received from Reserve as operating fees, reactivating fees in the event of termination, and all other compensation of every kind and character received by Midland for all operations performed under said Operating Contract.

Section 5. It is understood between Midland and Bay that, in carrying out the terms of the Operating Contract, the amount paid by Midland for compensation to employees, employees' profit sharing, employees' pension costs and Social Security Taxes might not be reimbursed either in whole or in part by Reserve. The pension costs herein referred to shall be those costs to be incurred under Midland's pension plan now in effect. The Profit Sharing Costs shall be those costs to be incurred under Midland's Profit Sharing Plan now in effect, or

those costs incurred under a special plan instituted for the employees employed under the Operating Contract, the cost of which shall not be greater than Midland's plan now in effect.

Midland shall maintain an account showing the total amount of gross fees received from Reserve and all expenses incurred by Midland and held to be non-reimbursable by Reserve.

It is further understood between Midland and Bay that in determining the amount to be paid by Midland to Bay under Section 4 hereof, the expenses incurred by Midland as aforesaid which are not reimbursed by Reserve shall be deducted by Midland.

Section 6. It is further understood between Midland and Bay that there may be other expenses incurred by Midland and/or Bay other than those enumerated in Section 5, that are clearly not reimbursable by Reserve under the terms of the Operating Contract and such expenses if incurred by Midland shall be deducted in determining the amount to be paid by Midland to Bay under Section 4 hereof and if incurred by Bay, Bay shall be reimbursed by Midland to the extent of 65% of such expenses; provided however, that any of said expenses must have the written approval of Midland or Bay, as the case may be, before being incurred.

Section 7. To the extent that Midland is not reimbursed or held harmless by Reserve under the said Operating Contract, Bay agrees to indemnify and pay over to Midland thirty-five per cent (35%)

of any amount paid or expenses incurred by Midland (including attorney's fees, court costs and investigation expenses) in settlement or in defense of claims of any kind whatsoever made by third persons for the destruction of property (whether owned by Reserve or others), or injury to, or death of said person or persons arising out of, or in any way connected with the performance of work under the Operating Contract. Midland shall notify Bay with respect to all such claims and shall consult with Bay with respect to the investigation, defense, settlement, or other disposition of all such claims; provided, however, that in the event of disagreement between Midland and Bay, the decision of Midland shall be conclusive and binding upon Bay. It is further understood and agreed that in the event Reserve directs Midland to insure against any of the matters covered by Section 2 of the Operating Contract and Midland fails, refuses or neglects so to do, then and in that event Bay shall have no liability for any such claim or claims as in this Section provided.

\* \* \* \* \*

Section 11. The term of this Agreement shall be co-extensive with, and limited to, the term of said Operating Contract.

\* \* \* \* \*

(Deposition and exhibits received in evidence and marked Plaintiff's Exhibit 27.) [140]

## PLAINTIFF'S EXHIBIT No. 27

## DEPOSITION OF JOHN L. CONNOLLY

Whereupon,

## JOHN L. CONNOLLY

of lawful age, being called, sworn and examined as a witness, deposeth and saith: [2]

\* \* \* \* \*

A. John L. Connolly; Saint Paul, Minnesota.

Q. (By Mr. Bouchard): And what is your business or occupation?

A. I am General Counsel and Secretary of the Minnesota Mining & Manufacturing Company.

Q. And as such secretary, I assume that the records of the company are in your custody?

A. I would say yes.

Q. Have you any connection with the Midland Rubber Company?

A. I would have to refresh my memory but my recollection is that I am Secretary of the Midland Rubber Company—yes, secretary.

Q. Will you tell us, please, what the relationship of Midland Rubber Company is to Minnesota Mining & Manufacturing Company?

A. Midland Rubber Corporation is a wholly-owned subsidiary of Minnesota Mining & Manufacturing Company.

Q. And I assume as such secretary, the records of Midland are in your possession and custody?

A. Well, I think they are all in Saint Paul. They are available. Some of them might still be out on the West Coast, but I don't think so.

(Deposition of John L. Connolly.)

Q. Now, will you refer to the original of the agreement dated August 28, 1950 between—for brevity—R. F. C., Minnesota and Pacific. Do you have the original before you, [4] Mr. Connolly?

A. This (indicating) is the original.

Q. May I see it, please?

(Witness hands document to counsel.)

Q. You have handed me, Mr. Connolly, a bound volume containing some records of Minnesota in connection with the Synthetic Rubber Plant contracts at Torrance, California, and called my attention to schedule "A" which is the original of the contract I have previously referred to? Is that right?

A. That is right.

Q. Now in this contract, which for convenience I shall refer to as the Torrance Operating Agreement, R. F. C. is designated as Reserve, Minnesota Mining & Manufacturing Company is designated as Operator, and Pacific Rubber Company is designated as Pacific? That is correct, is it not?

A. It is my recollection.

Q. And when the word Plant is used in this agreement, it refers, does it not, to the government owned plant which is more commonly known as the Torrance Copolymer Plant?

A. That is right. I think it is referred to as Plancor 611—that is the government's designation of it.

Q. Yes. Mr. Connolly, did you as Secretary and General Counsel of Minnesota Mining participate in the negotiation of this contract with R. F. C.?

(Deposition of John L. Connolly.)

A. I did, together with one of the Assistant General [5] Counsel, Robert Tucker, and our Patent Attorney, Mr. Carpenter.

Q. You mean Counsel for Minnesota Mining?

A. Yes.

Q. Were these negotiations with R. F. C. carried on for the most part in Washington, D. C.?

A. They were all carried on in Washington, D. C. or over the telephone.

Q. And when you say in Washington, I assume that is the Washington Office of the R. F. C.?

A. That is right; Vermont Avenue.

Q. Do you recall when these negotiations first started? A. Yes, I do.

Q. When?

A. Well, it was sometime prior to August 27, 1950.

Q. In any of these negotiations leading up to the execution of this contract, did anyone in behalf of Pacific Rubber Company participate in those negotiations? A. Yes.

Q. Who?

A. Mr. Kerr, Mr. Judson, and I am not too sure if Orris Hedges was in Washington or he came back here after we came back from Washington.

Q. Were there any other representatives of Pacific who participated in those negotiations that you recall?

A. Well, you are speaking now about in Washington? [6]

Q. Well, let's start first in Washington.

(Deposition of John L. Connolly.)

A. When I say Mr. Kerr and Mr. Judson, I am referring to the meeting we had in Washington with the officials of R. F. C. in our negotiations with R. F. C.

Q. Yes.

A. But if you want to know who participated in the negotiations between Minnesota and the Pauley Interests, that is a different question.

Q. I see. Well, all right. We will try to cover that separately, then. The only representatives then in behalf of Pacific Rubber Company who actively participated in negotiations in Washington with the R. F. C. were Mr. Kerr, Mr. Judson, and possibly Mr. Hedges? Is that your recollection?

A. I am talking about when I was present on this contract and that had to do with the form of the contract, only.

Q. Had the terms of the contract been agreed upon by you and the Minnesota officials prior to any participation by Pacific? A. No.

Q. So Pacific representatives, whoever they may be, participated in negotiating the terms with you and Minnesota representatives?

A. Well, are you speaking now about before we went to Washington or in Washington?

Q. Now I am talking about Washington. [7]

A. Well, what we were doing in Washington—I think it was on or about the 28th of August, 1950—with Mr. Kerr, Mr. Oakes, Mr. Tucker, Mr. Carpenter, and Mr. Judson were working out the form of the agreement, what form the contract would take.

(Deposition of John L. Connolly.)

Q. I see.

A. The agreement as between the Pauley Interests and Minnesota had been worked out previous to that date.

Q. I see. Who is Mr. Oakes, Mr. Connolly?

A. He is B. J. Oakes, President of the Midland Rubber Corporation.

Q. And who were the other gentlemen?

A. R. H. Tucker is one of my assistants and E. G. Carpenter is Patent Attorney for Minnesota Mining & Manufacturing.

Q. Now, prior to your negotiations in Washington, I understood you to say that there had been dealings between Minnesota and Pacific with respect to this proposed contract? Is that right?

A. That is correct.

Q. I take it that you represented Minnesota in those negotiations?

A. Not solely. I was one that participated.

Q. Who else in behalf of Minnesota?

A. Well, as I recall it, Mr. McKnight, Mr. Carlton and [8] Mr. Buetow. Now, whether Mr. Bush was in the meeting or not, I do not know.

Q. Where was the meeting held to which you refer?

A. The Board of Directors Room in this building.

Q. And who in behalf of Pacific Rubber Company was present?

A. Mr. Judson, Mr. Kerr, Mr. Pauley and I don't recall anybody else. I don't recall whether

(Deposition of John L. Connolly.)

Orris was here at that time or whether he came on later, but I know he was here before we finally executed all these contracts. [9]

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Did Mr. Pauley participate as a representative of Pacific in the negotiations with R. F. C. representatives, in securing this contract?

A. I wouldn't know that. I understand that he did.

Q. At least he didn't do it cooperation with you, or at least in any meeting in which you were present with Mr. Pauley?

A. I think I better answer that question in this way: We had made an application through Mr. Hadlock for the operation of this plant.

Q. When you say "we," who do you mean?

A. Minnesota. [11]

Q. Yes?

A. Through Mr. Carlton, who was president of our company at the time. Later on we were told that it was the policy of the R. F. C. to get more than one operator interested in it and we were also given the names of some other people who had made applications for the operation of the same plant, including the Pauley Interests.

I understand—and I only get this through Mr. Pauley and from what I heard from Mr. Carlton and Mr. Hadlock—that the Pauley Interests had made application. Also, I understand, and I get this again through Mr. Carlton, our president at the

(Deposition of John L. Connolly.)

time, that we would have to go out and secure someone to help us in the operation of this plant. I shouldn't say "help us," but we had to secure another company because they wanted to broaden it all out.

Now, who participated in the negotiations prior, we do not know—I do not know. When I am talking about this deal here when we went down there on a Monday—I got there on a Tuesday, but it is my understanding that Mr. Pauley, Mr. Judson, Mr. Kerr, and Mr. Oakes, and Mr. Hayes—he was Jim Hayes who was an officer of Midland at the time, were in this meeting and they all went in to Washington on Monday and reported that we had agreed among ourselves as to the parts to be played by the two companies.

Q. I see. Was Mr. Pauley there at that meeting in [12] Washington? A. Which meeting?

Q. That you have just referred to when you got there on Tuesday.

A. No. The only purpose of that meeting was to draw up a contract.

Q. I see.

A. Mr. Judson, Mr. Kerr, Mr. Tucker, Mr. Carpenter and I,—Mr. Carlton wasn't there; it was a question of what type of contract we were going to form.

Q. Mr. Judson was there, I take it, as attorney for the Pauley Interests? A. That is right.

Q. And the Pauley Interest was the Pacific Rubber Company, was it not?

(Deposition of John L. Connolly.)

A. Well, at that time I don't know.

Q. Well, at least Pacific Rubber Company was the company that became a party to the agreement with Minnesota?

A. Later on, that is true; but before we left for Washington, we had drawn up an agreement between the so-called Pauley Interests and ourselves.

Q. Was that agreement in writing?

A. Yes, sir.

Q. Do you have a copy of that?

(Brief pause.) [13]

A. I am sorry. I have a copy of it in the file, here; I saw it this morning.

Mr. Hedges: Off the record.

(Discussion off the record.)

A. I will show you my signed copy of it, signed by myself and Mr. Pauley, and this I will take out if you want a copy.

Q. (By Mr. Bouchard, continuing): I would like to have a copy, if I may. [14]

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Mr. Connolly, at the time of these negotiations had you heard of Pacific Rubber Company?

A. You are speaking now of the 27th of —

Q. August, 1950.

A. Yes. I had heard of the name mentioned, yes.

Q. And were you acquainted with any of the officers or directors of that company?

A. Not unless Mr. Pauley was one, but I just met him the day before.

(Deposition of John L. Connolly.)

Q. Did you know that Mr. Pauley was interested in Pacific Rubber Company?

A. I understood that he had some connection with it.

Q. Had Mr. Pauley represented to you that he had some connection with it or some interest in it?

A. Well, I couldn't say that he did. There was some discussion of it, but what it was now I don't know. You see, that agreement was drawn up by Mr. Judson and myself on a Sunday following the first time that I had ever met Mr. Pauley, which was the 26th.

Q. Yes. At least so far as you now know, no officer or director of Pacific Rubber Company had ever represented [15] to you that Mr. Pauley was interested in Pacific Rubber Company?

A. I think that is a fair statement.

Q. And if I correctly understand your testimony today, Mr. Connolly, it is that it was your understanding that prior to the time Minnesota Mining had negotiated with R. F. C., that the Pauley Interests had likewise negotiated for an agreement covering this plant? A. That is right.

Q. When you testified, Mr. Connolly, that R. F. C. was interested in getting more than one rubber company interested in the operation of these synthetic plants, you meant by that, did you not, that R. F. C. was interested in having more than one company participate in the operation?

A. Well, when you say, "participate in the operation," I don't know as I quite go along with that.

(Deposition of John L. Connolly.)

Q. I don't think my question is a fair one and I think you picked out the weakness in it. Isn't this a fair statement, that R. F. C. was interested in having some responsible company as the operator of those plants but have other companies participate in, let's say, the profits if there are any? Isn't that a fair statement?

A. No. I don't think that is fair, either.

Q. Well, will you tell us then?

A. It is my understanding that you are speaking now [16] about the 27th day of August and prior thereto?

Q. Yes.

A. That R. F. C. was interested in getting as many companies as they could interested in the rubber program so that they would bring in more know-how, that was my understanding; but not to participate, not just to participate in the fee.

\* \* \* \* \*

Q. Yes. Now, Mr. Connolly, I show you the original contract of R. F. C. and I want to call your attention to Section 2 of that agreement which provides in part as follows: [17] "So long as this contract remains in full force and effect, operator shall procure and maintain insurance, provided such insurance is obtainable, of such kind and character as Reserve shall direct and in such companies and in such amount and shall be satisfactory to or required by Reserve, protecting against loss of or damage to the plant, or against liability to third parties by reason of the activities carried on by operator pur-

(Deposition of John L. Connolly.)

suant to this contract, or against such other contingencies as may be specified by Reserve."

First, let me ask you, in that contract is it not true that Minnesota Mining Company is referred to as the operator?      A. That is correct.

Q. Did your company, Minnesota, as operator receive from R. F. C. any instruction as to the insurance coverage which R. F. C. would require in connection with the operating of this Torrance Plant?

A. Not to my knowledge. I have no personal knowledge, but I understood that they did.

Q. And was the insurance coverage secured by Minnesota covering the operation of the plant?

A. Well, I can tell you what insurance coverage they did have.

Q. Will you do that, please?

A. This is what was given to me by the insurance [18] schedule that was in effect under Mid-and. Now, I do not have before me what Minnesota had but I assume it was the same thing. It had to do with workman's comp and that was the Industrial Indemnity. There was another policy with the Anchor Casualty Company, one hundred to one hundred thousand and five thousand liability and I think that referred to—from looking at this—automobile insurance.

Then we have the Republic Indemnity Workman's Comp. Why there are two policies, I don't know. One is dated 1951 and the other, February 28, 1952, the second one.

(Deposition of John L. Connolly.)

Mr. Hedges: They are continuations, I believe.

The Witness: Continuations?

Mr. Hedges: Yes.

A. (Continuing): Then the next one is the Insurance Company of North America and that appears to be liability and five thousand auto property damage. Then again we have workman's comp, Republican Indemnity, 1953; and again we have the Insurance Company of North America, 1953 that is the same auto liability; and 1954, workman's comp; and again in 1955, Republic Indemnity Workman's Comp; and again the same type of insurance by the Insurance Company of North America for automobile; and the Pacific Indemnity appears to be 1954-'55, boiler and machinery.

Q. (By Mr. Bouchard, continuing): And what is the amount? [19]

A. Well, there is no amount to the workman's comp. That covers everything.

Q. Yes?

A. Now, the auto policy is a hundred to a hundred thousand, bodily injury, and five thousand, property damage. That runs throughout all this.

Q. What is the personal injury insurance coverage?      A. Personal injury?

Q. Yes.      A. Other than automobile?

Q. Yes.      A. I don't find any here.

Q. You do not find any?      A. No, sir.

Q. Would you let me see that, please?

A. Surely.

(Witness hands documents to counsel.)

(Deposition of John L. Connolly.)

Q. I notice on this schedule you have handed me, Mr. Connolly, that you have one policy in the Anchor Casualty Company, bodily injury, from a hundred to a hundred thousand dollars, which the premium is \$2,087.06. You have another policy in the Insurance Company of North America covering the same type of liability, bodily injury, from a hundred to a hundred thousand and your premium was \$3,598.45; and you have a third policy in the Insurance Company of North America [20] covering bodily injury, a hundred to a hundred thousand; and another policy in the Insurance Company of North America covering bodily injury of a hundred to a hundred thousand, which the premium was \$1,978.94.

I notice that the second policy, the last one I just referred to, dated 9/11/54, and the previous one, 9/11/53—they are all renewals. So I would take it from this sheet that the maximum bodily injury insurance that was carried was from a hundred to a hundred thousand at any one time? Is that to your recollection?

A. I don't so interpret that sheet. I interpret that to have reference to automobile liability. I couldn't swear to it, but that is the way I read it.

Q. Well, then it is your view, Mr. Connolly, that Minnesota Mining carried no personal injury insurance other than automobile insurance in connection with the operation of the plant?

A. I have no knowledge on the subject.

Q. You don't know whether it did or not?

(Deposition of John L. Connolly.)

A. I do not know, no.

Mr. Hedges: You kept referring, Mr. Bouchard, to the insurance being one hundred to one hundred thousand. That, as I understand it, is one thousand for death or injury to one person and one hundred thousand to two or more, in insurance language?

Mr. Bouchard: I stand corrected. You are absolutely right.

Q. (By Mr. Bouchard, continuing): Now isn't it a fact, Mr. Connolly, that Minnesota as the operator of this contract charged all of these premiums for insurance carried on the Torrance Plant to R. F. C. as a cost of operation?

A. Well, they charged to R. F. C. everything they agreed should be put on the plant and that they would stand for. Now, whether that is all of this or not, I don't know, but I assume so.

Q. I think the contract provides that all the insurance required by R. F. C. to be carried is a reimbursable cost of operation.

A. That is right.

Q. I would like to call your attention, if you will refer to it, please, to Section 12 of the Operating Agreement which states in part as follows.

A. I have it.

Q. "It is understood that in the performance of this contract, Operator is acting as agent for Reserve for the account and at the expense and the risk of the latter, and that accordingly Operator shall in no event be liable for but shall be held harmless by Reserve against any damage to or loss

(Deposition of John L. Connolly.)

or destruction of property, whether owned by Reserve or others, for any injury to or death of persons in any [22] manner arising out of or in connection with the work hereunder, unless it be shown to have been caused directly by bad faith or wilfull misconduct on the part of any officer of Operator, or any representative of Operator, having supervision and direction of the plant as a whole, or of the operating facilities or of the standby facilities, acting within the scope of his authority and employment, or unless it results from the failure of Operator to carry such insurance coverage as Operator may be required to carry under this contract."

Do you recall, Mr. Connolly, in the negotiation of this Torrance Operating Agreement any particular discussion which you had with representatives of the R. F. C. with respect to the meaning of Section 12 of that agreement?

A. Yes, we had a great deal of discussion about it.

Q. Is it your recollection that that section of the agreement, Section 12, was drafted by you or your company, or was it a provision that was drafted by representatives of R. F. C.?

A. It was drafted by representatives of R. F. C., and there is another provision somewhere else that limits liability of our company, even for an overt act, to a million dollars.

Mr. Hedges: That is, you are referring to Section 31? [23]

A. (Continuing): Section 31 was the result of

(Deposition of John L. Connolly.)

our negotiations and it reads as follows: "Reserve agrees that notwithstanding any other provision of this contract, the summation of all liabilities of Operator arising out of any provision of this contract or any operations conducted thereunder, shall in no event exceed the total amount of one million dollars," words and figures.

Q. (By Mr. Bouchard, continuing): All right. Now, let's go back to Section 12 a minute, if you will. You say that that provision was inserted and drafted by the representatives of R. F. C. Now, you did not object to the inclusion of Section 12, of that clause, excusing R. F. C. from its duty to indemnify in the event of loss which was attributable to the wilfull misconduct or bad faith of one of Minnesota's officers, did you? A. Did we object?

Q. Yes. A. We sure did.

Q. You did object to it? A. Oh, yes.

Q. And how did the clause happen to be inserted? A. You mean 12?

Q. Yes.

A. Oh, that is an old provision that has been inserted in all of these contracts for many, many years. [24]

Q. Now, when you came down to the drafting of this particular contract, you didn't object to the inclusion of Section 12 in this contract, did you? A. Oh, yes, we did.

Q. But your objection was without—

A. It was watered down by the provision of 31;

(Deposition of John L. Connolly.)

it was either take it or else. That was the best deal we could get.

Q. In other words, the government insisted, R. F. C. insisted on Section 12 as worded in the final agreement? A. If not, no contract.

Q. All right. Now, did you construe the inclusion of Section 12 in this contract as any lack of confidence by R. F. C. and the officers of Minnesota Mining?

A. No, sir, because if so they would have lack of confidence in the whole rubber industry. I was told that this was the same provision that was in the other contracts.

Q. In all of them? A. Yes.

Q. Yes. It was a common and the usual provision, was it not? A. That is right.

Q. And it wasn't intended by R. F. C. as any reflection on the confidence of the officers of this company or any other rubber company that it entered into an agreement with, isn't that true? [25]

A. I assumed it was.

Q. May I ask you, Mr. Connolly, how many years you have been an officer of Minnesota Mining?

A. I have been Secretary, if I recall correctly, since 1939. I may be mistaken about a year or so, but that is my recollection.

Q. And associated with the company prior to that time? A. Since July 1st, 1937.

Q. May I ask you, Mr. Connolly, has there ever been any insurance of which you are aware where

(Deposition of John L. Connolly.)

a loss was suffered by your company for injury to or death of a person, or for injury to property of a third person, where the loss was directly attributable to the wilfull misconduct or bad faith of any officer of your company, or of any plant superintendent of your company acting within the scope of his authority?

A. Not to my knowledge, but I know that there has been some where we failed to carry insurance.

Q. That would happen in any event, wouldn't it?

A. That was one of the contingencies that we had in this Number 12.

Q. Yes. If an injury occurred in the operation of any plant operated by Minnesota Mining in which it was not covered by insurance, your company would be responsible, assuming it was negligence, whether or not it was due to bad faith? Isn't that true? [26]

A. Well, that wasn't the test in this. The test was even though you had insurance, if there was bad faith connected with it, you were still stuck with it to the extent of a million bucks.

Q. That is correct.

A. And you were also stuck if you failed to carry the type of insurance that they recommended to you, which I figured was more dangerous than the other.

Q. Do you mean by that answer, Mr. Connolly, that R. F. C. requested Minnesota as Operator of this Torrence plant to carry certain kinds and

(Deposition of John L. Connolly.)

amounts of insurance which Minnesota did not carry?

A. No, but I thought it could be possible that they might have and that we had failed to do that, and if a loss resulted they would come back against us and we would have to go to our associates for their share. [27]

\* \* \* \* \*

Q. Didn't you carry any insurance at all on the operation of the Torrance plant protecting yourself against liability for personal injury or death or property damage?

A. Well, if this schedule is all-inclusive, as I interpret it, the answer is no. Now whether it is all-inclusive, I don't know. My understanding is that this is what they asked us to carry; this is what we charge back to them. Now, whether we had other insurance or not—they haven't given me the schedule.

Q. Someone in your organization would be able to give us that information, would they not?

A. I would assume so.

Q. Rather than take your time, would you be good enough to make inquiry and let us know what insurance was carried protecting the company against death or personal injury or property damage in connection with the operation of the Torrance plant? [28]

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Now that contract between Minnesota and Pacific was the

(Deposition of John L. Connolly.)

formal document that carried into effect, I assume, the previous understandings that you had with Mr. Pauley as evidenced by Plaintiff's 1 that we have already offered in evidence? Is that right?

A. That is right.

Q. Was Mr. Pauley present, do you know, when that contract [30] in behalf of Pacific Rubber Company was executed?

A. Well, I wouldn't know. We executed a copy here and it is my recollection that we either mailed it to Mr. Judson or Mr. Hedges and they had it executed out there and sent back.

Q. I see. Between the time of Plaintiff's Exhibit 1, which I think is August 27, 1950, and the date of the execution of this agreement on September 20th, did you have further discussions with Mr. Pauley with reference to the terms of the formal document? A. No.

Q. So that when you as secretary of this company executed that agreement between Minnesota and Pacific, was it your understanding that Pacific Rubber Company was the Pauley Interests as indicated by your previous letter to him of your understandings?

A. Well, I never gave much thought as to whether it was Pauley Interests or not because this contract was constructed, this particular one, by Mr. Hedges, Mr. Judson, and Mr. Kerr, and myself in this office and we had certain provisions going back and forth, putting them in and taking them out, and those gentlemen talked to Mr. Pauley as to what

(Deposition of John L. Connolly.)

conditions and provisions should go in and when they said "This is the way it is going to be," I accepted it.

Q. Yes, but—— [31]

A. I never talked to Mr. Pauley personally that I can remember now about the details.

Q. But you felt that in executing this contract with Pacific Rubber Company, you were carrying out your previous letter agreement with Mr. Pauley? A. I understood we were, yes.

Q. Now, Minnesota Mining and Pacific—the contract states that the agreement by and between the parties is "in consideration of the premises and the mutual covenants herein contained." Isn't it true, Mr. Connolly, that the consideration flowing from Pacific Rubber Company to your company was 35 per cent of the net compensation which your company received from R. F. C. less certain adjustments resulting from any costs of operating the Torrance plant which were not reimbursable to your company under the terms of the operating agreement with R. F. C.?

Mr. Hedges: I object to the form of the question. The instrument speaks for itself.

Q. (By Mr. Bouchard, continuing): Well, are you able to make an answer to that, Mr. Connolly?

A. I kind of got lost—which consideration? Flowing from us to them?

Q. Yes. All that Pacific got was 35 per cent of the net management fee that Minnesota Mining got from R. F. C.?

(Deposition of John L. Connolly.)

A. No. I think if you read all of the contracts, the [32] M-P and the other agreements, there was more than that but I would have to refresh my memory. There is a patent agreement here dated the same date between the same parties in which the parties agree that they will do certain things which would be to the mutual benefit of the respective parties.

Q. If any patent grew out of this operation?

A. If any patent grew out of this operation; so when you confine the consideration flowing from us to Pacific to 35 per cent, I can't go along with that.

Q. You add to that, I take it then, a benefit to Pacific from any patent that might result?

A. Well, and research. Not only patents, but a lot of research that is set forth in this patent agreement.

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Now that operation, of course, has now been terminated, has it not? The operation [33] of the Torrance plant by Minnesota and Pacific?

A. That is right. The plant has been sold to the Shell Oil Company.

Q. Were any patents secured by either Minnesota or Pacific as a result of its operation of that plant, the benefit of which went to either Minnesota or Pacific? A. Not to my knowledge.

Q. Did Pacific perform any services which

(Deposition of John L. Connolly.) amounted to managerial assistance to your company in that operation?

A. I understood they did.

Q. Do you know of your own knowledge whether they did or not?

A. The only knowledge I have is that Mr. Kerr had performed certain services and was endeavoring to perform others which were not successful to the entire venture. Now, as to the other details, I wouldn't have any information.

Q. Was Mr. Kerr at any time on the payroll of Minnesota Mining Company? A. No, sir.

Q. Do you know what the nature of the services rendered by Mr. Kerr were?

A. Well, it is my recollection that Mr. Kerr was instrumental in obtaining certain employees out there and assisted Dr. Oakes, and he was also attempting to get raw material; things of that nature. [34]

Q. Was the personnel with which he was instrumental in securing, personnel of a technical character? A. I really do not know.

Q. In the agreement—and I agree with Mr. Hedges that the agreement will speak for itself—but I will ask you if you recall in that agreement, Mr. Connolly, whether or not Minnesota received consideration from Pacific because of its covenant to indemnify your company against any losses which might be incurred—do you feel as an officer of Minnesota Mining that that covenant on the part of Pacific Rubber Company to indemnify Minnesota

(Deposition of John L. Connolly.)

for any losses was a consideration to your company for execution of the contract?

A. Well, I never have given any thought to that, but I would have to refresh my memory as to what provision there is in here on that subject. Do you recall what section it is?

Q. I would think perhaps that would be your Section 31. A. No, but I mean in the M-P—

Q. Oh, in the M-P agreement; frankly, I don't have a copy of it.

Mr. Bouchard: Off the record.

(Discussion off the record.)

Q. (By Mr. Bouchard, continuing): Will you refer to Section 7, please?

Mr. Hedges: Of the M-P?

Mr. Bouchard: Of the M-P agreement. Section [35] 7 contains this sentence: "It is further understood and agreed that in the event Reserve directs Minnesota to insure against any of the matters covered by Section 2 of the operating contract and Minnesota fails, refuses or neglects so to do, then and in that event Pacific shall have no liability for any such claim or claims as in this section provided."

Now is it your understanding of that provision, Mr. Connolly, that this clause means that Pacific Rubber Company's agreement to indemnify you, Minnesota, was binding only in the event that your company did in fact carry insurance coverage which R. F. C. insisted upon and which R. F. C. agreed to pay for?

(Deposition of John L. Connolly.)

Mr. Hedges: I object again to the form of the question.

Mr. Bouchard: Well, Mr. Connolly can answer it if I have been clear enough. If not, I will re-state it.

A. I think I understand your question. I just wanted to read that Section 7 again. I think the answer to your question is no, if I understand it correctly. It is my recollection that Section 7, after reading it over, is that in the event we were obligated to pay any amount under that provision 31, with a combination of 12, that they would reimburse us to the extent of 35 per cent unless we were requested by Reserve to cover it by a policy and we failed, neglected [36] or refused—in that event, they would pay us nothing.

Q. (By Mr. Bouchard, continuing): Yes. So under that clause Pacific was liable to your company only in the event that your company actually carried insurance which R. F. C. required? Isn't that true?

A. No, no. No, I don't agree with that at all.

Q. Under what circumstances is it your view that Pacific then would be liable to you, Minnesota?

A. Well, in the event that something happened and there was an accident and there was damage and we had to pay out, we will say, a million dollars. Pacific would be required to pay us \$350,000.

Q. Regardless of how the accident happened?

A. That is right; regardless of how the accident happened.

(Deposition of John L. Connolly.)

Q. Even if it was an accident just involving negligence of some employee of Minnesota?

A. No, I wouldn't agree to that. It had to be an overt act before we are liable in the first place; either an overt act or the failure to insure against something that Reserve asked us to do.

Q. Isn't it a fact that the only instance in which Minnesota could be liable to Reserve was in the case of an accident or death or property damage which was caused solely by the bad faith of an officer of Minnesota or an employee in a managerial capacity? [37]

A. No.

Mr. Hedges: I object to the form of the question; it is argumentative; and the contract speaks for itself.

Q. (By Mr. Bouchard, continuing): That is not your interpretation?

A. That is correct. I thought I had given my interpretation.

Q. I think you had. I wanted to pinpoint it a little more if I could. I realize you testified, Mr. Connolly, that you were not familiar with what insurance R. F. C. may have required you, Minnesota, to carry and you are going to get that information for us, but are you in a position to state this: Do you know whether or not Minnesota carried the insurance that R. F. C. required them to carry in connection with the operation of the Torrance plant?

A. I would say we did, yes, because it was all reimbursable.

Q. Yes. Let me ask you this, Mr. Connolly:

(Deposition of John L. Connolly.)

Would it be your opinion that under your agreement with Pacific that Pacific was liable to you only for a liability incurred which was not reimbursable to Minnesota by R. F. C.?

Mr. Hedges: May I have that question again?

(Question read by the reporter.)

Mr. Hedges: I object to the form of that question, [38] too. The contract speaks for itself. He can't interpret the contract.

Q. (By Mr. Bouchard, continuing): I would like to have your opinion of it, if you will, Mr. Connolly, in answer to my question.

A. Well, I think we have to define our terms, and this is just my opinion for what it is worth. Certain types of risk, R. F. C. was going to take themselves; other types they demanded that we insure for them and if we failed to insure for those, we were liable—that is between Minnesota and R. F. C. and Midland later on.

As between ourselves, Minnesota and Pacific, Pacific having no control over the management and the particular employees, they wouldn't know whether or not we got all the insurance that R. F. C. asked us to; and we put that in as an exception and that they would not be liable if we failed to do that.

Now, on the ones that R. F. C. says we are to carry and we will not reimburse you for those if it is committed by an overt act, then we look to Pacific for 35 per cent of it. That is my understanding of the whole thing. But, if Pacific could prove that through our neglect out there on the

(Deposition of John L. Connolly.)

Coast we neglected to insure for something that R. F. C. stuck us for, they didn't have to reimburse us. [39]

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): I would like to clear up one thing, Mr. Connolly, if you can help me: You have testified that it is your opinion that Minnesota Mining carried all of the liability required by R. F. C. Now, if you did and an injury or death or damage to property resulted, you would be covered by your insurance; but if there was a liability above it, R. F. C. still accepted that liability, did they not, as per your agreement with them in the operating agreement?

A. Well, it is my recollection that R. F. C. did not require us to insure against the plant blowing up in its ordinary operations and they would hold us harmless against that type of loss; but if one of the officers committed an overt act and actually goes so far as to set a torch to it and blow it up, they only took the liability over a million dollars and they look to us for the balance of it.

Q. Yes.

A. That type of insurance they did not indemnify us for—either one of those types, the plant blowing up—nor did they require us to carry insurance on it.

Q. And your illustration of some employee putting a torch under one of the boilers and blowing it up is what you have in mind in reference to an overt act?

(Deposition of John L. Connolly.)

A. That is right, but it would be a managerial employee, [40] I think are the words that are used in the contract.

Q. Yes. A. Or an officer.

Q. Yes. Now, at the time of the Minnesota-Pacific contract that was executed on September 20, 1950, did Minnesota Mining receive a personal guarantee from Mr. Pauley guaranteeing any loss or any claim against Pacific? Or to state it another way, did Mr. Pauley at the date of the execution of this contract between Minnesota and Pacific, give Minnesota Mining his personal guarantee that Pacific Rubber Company would be able and would respond to any liability?

A. He did not.

Q. Now I think, Mr. Connolly, sometime in June of 1951 Minnesota Mining Company transferred its interest under the operating agreement to its subsidiary, Midland Rubber Company, is that correct?

A. June doesn't quite ring a bell.

Q. I may be wrong on my dates there.

Mr. Hedges: Off the record.

(Discussion off the record.)

Q. (By Mr. Bouchard, continuing): What was the date of the assignment by Minnesota to Midland?

A. It is recited in this agreement as the 29th of June, 1951. [41]

Q. Did R. F. C. consent to that assignment?

A. Yes.

(Deposition of John L. Connolly.)

Q. Did you receive information, Mr. Connolly, on or about May 21, 1951 that Pacific Rubber Company had transferred all of its right, title and interest under the Torrance operating agreement and under the Minnesota-Pacific contract to a limited partnership known as Bay Rubber Company?

A. What was the date?

Q. May 21, 1951.

A. Well, somewhere along in there. I couldn't swear to that date.

Q. What evidence, if any, do you have in your file of that assignment by Pacific to Bay Rubber Company?

A. Well, I have a Termination Agreement signed by Mr. George Halpin, Executive Vice-President, and myself as Secretary, and Bay Rubber Company, General Partner, dated the 29th day of June, 1951.

Q. May I see that, please?

(Witness produces document.)

A. I probably have others but that is the first thing I find there.

Q. Mr. Connolly, you have shown me an original record in your files entitled "Termination Agreement," dated June 29, 1951, between Minnesota Mining and Manufacturing Company and Bay Rubber Company which is executed on behalf of [42] Minnesota Mining by Mr. Halpin, Executive Vice-President, attested to by yourself as Secretary, and by Bay Rubber Company, Edwin W. Pauley, General Partner. [43]

\* \* \* \* \*

(Deposition of John L. Connolly.)

Q. I would like to ask you a couple other questions, Mr. Connolly. I call your attention to Section 11 of the Minnesota-Pacific contract which reads as follows: "Neither party hereto shall sell, assign, or pledge its interests under this contract nor any of its rights, powers, privileges, [44] duties, or obligations hereunder without the prior written consent of the other and of Reserve."

Did Pacific Rubber Company request the prior written consent of either Minnesota or Midland to the assignment by it of its interests under the M-P contract to Bay Rubber Company?

A. I don't know what they did to Reserve but they did request our consent and we gave our consent.

Q. Do you have a copy of any letter or document from them requesting the consent of Minnesota?

A. I do not recall any letter. I recall a telephone conversation with Mr. Hedges.

Q. And did you give your consent in writing?

A. My recollection is that I did not but I haven't searched all the files to verify that. It was about the same time that we were asking them for their consent to transfer to Midland.

Q. Yes, but you do not recall whether you gave that consent in writing in behalf of Minnesota or not for Midland?

A. My best recollection is that I did not, other than enter into the agreement.

Q. Yes. Now, what written evidence is there of

(Deposition of John L. Connolly.)

Minnesota or Midland's consent to the assignment by Pacific to Bay, other than the document that you have already exhibited to us and another one of which you are having typed for us? [45] Is there anything else?

A. Not that I know of, no.

Q. Was Pacific's consent to the assignment by Minnesota to Midland given in writing, or was that done by telephone?

Mr. Hedges: Off the record.

(Discussion off the record.)

A. (Continuing): I have here a document dated the 29th day of June, 1951, and it is entitled as "Agreement of Assignment, Amendment and Guaranty," and it is signed by Minnesota Mining, Midland Rubber, Pacific Rubber and Reconstruction Finance Corporation.

Q. May I see that?

(Witness produces document.)

A. And as I recall, that is the authority from Pacific consenting to the assignment and Reconstruction Finance Corporation consenting to the assignment.

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Mr. Connolly, when you, in behalf of Minnesota, were requested orally on the phone by Mr. Hedges to consent to the assignment by Pacific [46] Rubber Company of its interest in the operating agreement with Bay Rubber Company, did you attach to your consent any strings?

(Deposition of John L. Connolly.)

A. I told Mr. Hedges, as I recall it, that it was too long and involved a story to be over the telephone, and if he would send me the document setting out all of these things, and I think we talked about resolutions and authority from Pacific, and so on, that I would go over them; and whether I told him at that time that we had to have a guaranty from Ed Pauley or not, I do not know, but that is one of the conditions before we accepted, before we finally consummated the deal.

Q. And why did you want that guaranty from Mr. Pauley?

A. Well, originally, it is my recollection that we talked about a guaranty from Mr. Pauley and when I saw the financial statement which was dated July 31, 1950, and I think the same date for the prior year, of Pacific Rubber Company and found that they owed \$725,000 to Oakland Rubber Company, I think we worked out a deal wherein and whereby Oakland Rubber Company agreed to subordinate the payment of its indebtedness during this period without our consent, and then we went along with Pacific Rubber Company's financial statement.

Q. And Oakland Rubber Company did consent to subordinate its indebtedness? A. Yes. [47]

Q. I think that is what you showed me a minute ago, was it not? May I see that consent?

(Witness produces document.)

A. That is back in 1950.

Q. You have handed me, Mr. Connolly, from your files, the original of an agreement between

(Deposition of John L. Connolly.)

Pacific Rubber Company and Minnesota Mining and Manufacturing Company, dated September 20, 1950. A. Yes.

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Plaintiff's Exhibit [48] Number 6, Mr. Connolly, which you have given us, is an agreement between Pacific, Oakland and Minnesota whereby Minnesota consents to assignment by Pacific to Bay and also providing that the subordination agreement of September 20, 1950, which is evidenced by Exhibit 5, is terminated.

Now, do I understand that as a consideration to the termination of the subordination agreement Minnesota demanded of Mr. Pauley his personal guaranty with respect to any possible liability of Bay Rubber Company?

A. I think that and others. It is my recollection that what happened was I understood that Pacific Rubber Company had disposed of its assets and was out of the business, disposed of to Mansfield either directly or indirectly—I have forgotten the details—and that one of the things that we wanted to get cleaned up was these outstanding subordination agreements and all these different things.

So we went through this process of eliminating all of those and wound up with a guaranty from Mr. Pauley because I didn't know anybody else that had any financial substance. Pacific, as I understood, was out of the picture.

(Deposition of John L. Connolly.)

Q. Did Minnesota or Midland, either one, require Mr. Pauley to give either Minnesota or Midland his personal guaranty of Bay Rubber's possible liabilities? A. Oh, definitely.

Q. As a condition to Minnesota consenting to the [49] assignment? A. That is correct.

Q. Yes.

A. Without that, we wouldn't have consented to it.

Q. Now, did Mr. Pauley give you such a guaranty? A. Yes.

Q. May I see it, please?

A. Here is the photostatic copy. I will show you the original.

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Do you know whether or not, Mr. Connolly, R. F. C. ever consented to the assignment by Pacific Rubber Company of its interests to Bay Rubber Company?

A. To the best of my knowledge, they did not.

Q. Did Midland Rubber Company and Bay Rubber Company execute a new contract between themselves covering the operation of the Torrance plant?

A. Yes. It is my recollection they executed the same type of contract in M-P and the patent agreement contract.

\* \* \* \* \*

Q. (By Mr. Bouchard): Mr. Connolly, at the time that Bay Rubber Company assumed liabilities of Pacific under the M-P contract, did you make

(Deposition of John L. Connolly.)

any inquiry as to the financial status of the partnership known as Bay Rubber Company?

A. To my knowledge, I did.

Q. You knew it was a limited partnership? [51]

A. That is right.

Q. And you knew that Mr. Pauley was a general partner? A. One of the partners, yes.

Q. And you knew that he was the general partner, did you not?

A. I think the document disclosed that.

Q. Yes. Did you make any independent inquiry as to Mr. Pauley's financial resources?

A. At that time?

Q. Yes. A. No.

Q. But you did in behalf of Midland require him to give his personal guaranty?

A. That is right.

Q. Did Bay Rubber Company give Midland Rubber Company any assurances that it could provide required services in connection with the operation of that Torrance plant?

A. We were assured we would get the same type of cooperation and Mr. Kerr would be in the picture the same as he was before.

Q. Who gave you those assurances?

A. Mr. Hedges and Mr. Kerr.

Q. Did Mr. Pauley make such representation?

A. No. I didn't talk to Mr. Pauley at that time. I talked to him later on about it. [52]

Q. I take it that as a result of those assurances given you by Mr. Hedges and Mr. Kerr, in any

(Deposition of John L. Connolly.)

event Midland Rubber Company looked to Bay Rubber Company—the partnership to continue to perform its obligations under the agreement the same as Pacific Rubber Company had in the past? Is that correct?

A. When you say "looked to Bay," we never had any contact with Pacific Rubber Company other than through Mr. Pauley and Mr. Kerr, and we looked to the same place with the Bay Rubber Company.

Q. Same people? A. That is right.

Q. Mr. Connolly, did you when you were requested by Pacific to consent to the assignment by it of its interest to Bay inquire from R. F. C. as to whether or not it was going to consent to that assignment?

A. No, sir. Personally, I didn't think it was necessary.

Q. Why?

A. Because I didn't think it was any of their business.

Mr. Hedges: You and I concurred for once, didn't we?

Q. (By Mr. Bouchard, continuing): Although Pacific was a party to the operating agreement with R. F. C. and Minnesota, was it not? [53]

A. As I understand "party," yes. I have forgotten how it was described.

Q. I think it was simply described as "Pacific."

A. Minnesota was described as "Operator."

Q. Mr. Connolly, do you have record of the pay-

(Deposition of John L. Connolly.)

ments which were made by Minnesota Mining Company to Pacific Rubber Company under the management and operating contract between the period January 15, 1951 and May 21, 1951?

A. I have asked our accounting department to compile such a record. That is the one I just asked my secretary to see if it was ready.

Q. And if it is not ready today, you will furnish that? A. I will furnish that.

Q. Fine. Thank you. Did you also in that request, Mr. Connolly, ask your accounting department to give us a statement of all of the fees paid by either Minnesota Mining or Midland to either Pacific Rubber and Bay Rubber?

A. I asked them to give us all the information requested in Questions 12 and 13 in your statement.

Mr. Hedges: Those can be forwarded to the reporter and marked as the next exhibits in order if you wish, as far as we are concerned.

Mr. Bouchard: All right. We will do that.

Mr. Hedges: I don't believe he can answer any questions in respect to that. [54]

Mr. Bouchard: All right.

Q. (By Mr. Bouchard, continuing): I take it, Mr. Connolly, that Pacific Rubber Company carried out its duties and rendered any services required to be rendered under the operating agreement? That is, up to May 21, 1951, when it assigned its interest to Bay, did it not? A. That is right.

Q. I take it by the same token that Bay Rubber Company did not perform any services under the

(Deposition of John L. Connolly.)

operating agreement prior to the time it became the owner under the assignment of May 21, 1951?

A. As far as I know, that is correct.

Q. In the M-P contract, Section 8, Mr. Connolly, that is the agreement between Minnesota and Pacific dated September 20, 1950—Section 8 provides as follows: "Pacific agrees that it will make no payment to Oakland Rubber Company, a California corporation, on account of principal or interest on any debt which is now or may be at any time hereafter owed to Oakland without the written approval of Minnesota."

I want to ask you, was this covenant by Pacific Rubber Company part of the consideration flowing to Minnesota Mining Company for the execution of the Minnesota-Pacific contract?

Mr. Hedges: That question is objected to as to form. He can answer it, if he can. [55]

A. I think I have said before that when I received the financial statement of Pacific showing an indebtedness of \$725,000 due on the note, I requested an agreement that Pacific would not make the payment and requested an agreement that Oakland would not receive the payment, and that their debt would be subordinated to any indebtedness that arose under this.

Q. Well, in making that request and getting a compliance with it, namely, that Oakland would subordinate its claim against Pacific to any claim Minnesota might have under this agreement, didn't you regard that as of value to Minnesota Mining?

(Deposition of John L. Connolly.)

A. Well, shall we turn it around and say without that—

Q. Let's not. I want you to answer my question and you can make any answer you want to it, but don't turn the question around, please.

Mr. Hedges: I think he is going to answer it by turning it around any way he sees fit.

A. Then if you don't like it, you can turn it around again. I was going to say without that, Minnesota, I do not think would have entered into this contract and assumed that possible million dollar liability without some reimbursement from somebody along the line. [56]

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Mr. Connolly, do you own either directly or indirectly any interest in Bay Rubber Company?

A. Neither directly nor indirectly do I own any interest in Bay Rubber Company.

Q. And to your knowledge do any officers of Minnesota Mining Company own any interest in Bay Rubber Company?

A. No. Not to my knowledge, no, sir.

Q. You know Mr. J. L. Hayes?

A. I know Mr. J. L. Hayes.

Q. Does he have any connection with Minnesota Mining Company?

A. He is employed here at Minnesota Mining Company and President of the National Advertising Company, one of its wholly-owned subsidiaries at the present time.

(Deposition of John L. Connolly.)

Q. And how long has he been in that capacity?

A. Well, you mean how long—

Q. Associated with Minnesota Mining?

A. Oh, since 1944, '41.

Q. And has been with the company continuously since that time?

A. Either with the company or one of its subsidiaries.

Q. Yes. You know, do you not, that Mr. Hayes owns an interest in Bay Rubber Company?

A. I do not know. I was told that he had an interest [57] in Bay Rubber Company. To what extent, I do not know.

Q. And do you know that he also is the owner as trustee of a partnership interest in Bay Rubber Company? A. No, I hadn't heard that.

Q. Did you know, Mr. Connolly, that at the time Bay Rubber Company was formed that an eight per cent interest in Bay Rubber Company was set aside to be assigned to the officers, or directors of Minnesota Mining Company?

A. No, I did not. Nor did I know it at the time it was formed nor since that time. I never heard of it until this moment. [58]

\* \* \* \* \*

Q. Mr. Connolly, did R. F. C. ever make any complaints to Minnesota about the assignment from Pacific to Bay?

A. Did they ever make any complaints?

Q. Yes.

A. Well, I don't know whether you would charac-

(Deposition of John L. Connolly.)

terize them as complaints, but they never approved it, if that is what you mean.

Q. Well, I understand that that is true and that that is your testimony, but I mean was there ever any indication on the part of R. F. C. that they were so dissatisfied with the arrangement that they considered terminating the whole deal?

A. I was never so advised. The first thing that I [59] ever heard of that was when some particular contract—I have forgotten what it was now—was signed by Bay Rubber Company and it is my recollection that they wrote to Dr. Oakes or somebody and said, "Who is Bay Rubber Company," and it is my recollection that either Mr. Kerr or somebody else representing the Pauley Interests went down and told them and they were requested, as I recall it now, to approve it and they never did approve it one way or the other.

But, they never advised me or anyone in our organization to my knowledge that they were talking about terminating the contract. When they talked to me about it, I told them we were getting the same amount of cooperation from the Bay representatives as we were getting from Pacific; and their only possible objection, as I recall it, was that Mansfield was already in the picture and that it now had acquired Pacific; and for Mansfield to get into the act again, they would have two operations and they didn't think that it should be done.

Q. As a matter of practice, isn't it true, Mr. Connolly, you have had much more experience with

(Deposition of John L. Connolly.)

the R. F. C. than I have—but isn't it true that R. F. C. as a general matter objected to anyone having an interest in synthetic rubber plants that wasn't engaged as an operator, an operating company?

A. Well, then if that were true, then they shouldn't [60] have put Pacific in there in the first place because Pacific was not operating the plant.

Q. But Pacific was operating its own plant in Oakland?      A. Oh, yes, yes.

\* \* \* \* \*

Q. (By Mr. Bouchard, continuing): Was Minnesota paid on a monthly basis by R. F. C.?

A. That is my recollection, but they did not always pay either Bay or Midland because we got into a hassle with the renegotiation board that we might be required to renegotiate some of these payments. So we held back a certain percentage until that was cleared up, and it was finally cleared up without any payments. [61]

\* \* \* \* \*

[Endorsed]: Filed Dec. 5, 1955.

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DAVID A. BLACK

called as a witness on behalf of the plaintiff; sworn.

The Court: State your name, please.

A. David A. Black—B-l-a-c-k.

Direct Examination

Q. (By Mr. Archer): Mr. Black, what is your business address?

(Testimony of David A. Black.)

A. 1100 Rowland Building, Los Angeles 13.

Q. What is your occupation?

A. I am an examiner of questioned documents and handwriting identification specialist.

Q. With whom are you associated?

A. I am associated with Clark Sellers, past president of the American Society of Questioned Document Examiners.

Q. Are you a member of any professional organization in connection with your work?

A. Yes, I am a member of a number, the principal one of which is the American Society of Questioned Document Examiners. [143]

\* \* \* \* \*

Q. Mr. Black, I show you a book of minutes of the Pacific Rubber Company, Plaintiff's Exhibit 15 for identification here, and ask you have you made an examination of the entire contents of this minute book?

A. Yes. May I take it apart briefly? Not all apart, but apart to some extent.

Mr. Dinkelspiel: Put it back together again.

A. Yes, exactly.

Mr. Archer: I will put it back together.

A. (Witness examining): Yes, this is the minute book that I have examined, every page of which I have examined. [150]

Q. (By Mr. Archer): When and where did you make that examination?

A. I made that examination in my office, 1100

(Testimony of David A. Black.)

Rowland Building, Los Angeles, on May 11, 12, 13, 16 and 17 of this year.

Q. What was the purpose of that examination?

A. The purpose of my examination was to determine if the minutes and other documents in the minute book were entirely regular in every respect or whether there was evidence of substitution of pages or other irregularity.

Q. What did your examination include?

A. It included an examination of the typewriting on each of the pages to determine whether or not all of the typewriting on all of the pages of individual sets of minutes and other documents was all done at the same time as a part of the same typing operation, what the conditions were as to whether or not the same paper was used in each of the minutes, within a group of pages representing one set of minutes. It included an examination of signatures and the ink in the signatures and other writing, if such there be in the various pages, to determine what light that might shed on the authenticity or otherwise of the minutes, and it included other examinations of other material, all to the same end, whether the minutes were regular and proper and authentic in every respect.

Mr. Dinkelpiel: May I ask the witness if he would explain what he means by the word "authenticity of Minutes"? [151]

A. Yes. Whether there was evidence—. Authenticity in the sense that an expert uses it, as to whether the conditions in the documents indicate

(Testimony of David A. Black.)

that something that purports to have been done all at the same time, such as a single set of minutes was actually typed all at the same time, on the same typewriter, under the same conditions, or when the typewriter was in the same condition, including the typewriter ribbon, and whether the paper was the same and whether regularity or similarity or uniformity is found or variance from one sheet to another or one condition on one page to a comparable condition on another. [152]

\* \* \* \* \*

Q. (By Mr. Archer): Now, I direct your attention to the minutes of the first meeting of the board of directors at 10:00 a.m., December 29th, 1948, consisting of eight typewritten pages in Exhibit 15, and ask you if you found anything to indicate substitution of pages in that group of pages.

A. Yes, I did.

Q. What did you find?

A. I found that in those eight pages of minutes for that first meeting of 10:00 a.m., December 29, 1948, in Exhibit 15, that the first four pages were typed on a machine which bore Royal elite type of the particular type font characterizing Royal elite typewriters before and up to 1945. [153]

\* \* \* \* \*

Q. (By Mr. Archer): Now, Mr. Black, I had asked you whether in those minutes of December 29th, 1948 at 10:00 a.m. in Exhibit 15, you had found anything to indicate substitution of pages in that group of pages, and I believe you testified that

(Testimony of David A. Black.)

these pages one through four which you have marked, were made under a certain kind of a typewriter; is that correct?      A. Yes.

Q. Well, would you continue your answer, then, to the question?

A. The first four pages, as I said, were written on a machine bearing Royal elite type of the period to 1945 and they had a fairly dark black impression and indicated a clean condition of the type.

The last four pages of the same minutes, pages five, six, seven and eight, which I shall mark in the same way as I have marked the first four (witness marking), I found were typed on a Royal elite machine, the same as the previous minutes, but of a distinctively different style of type characterizing Royal elite typewriters from the period 1945 to 1950. [155]

The typewriting in the last four pages, pages five, six, seven and eight, had a thicker type impression than the first four pages, and there was evidence of a somewhat dirtied condition of the type in some filled-in spaces showing in letters in the typewriting in the last four pages.

In the examination of the paper used in the eight pages of those same minutes, I found that the paper of the first four pages was what is known and shows in the watermark as "Whiting's Imperial Bond," and it had no tinting of the margins or edges of the paper.

The last four pages, pages five, six, seven and eight, on the other hand, I found with the brand and

(Testimony of David A. Black.)

watermark, "Super Linen Ledger," a different paper from the first four pages, and the Super Linen Ledger in the last four pages had a green tint of the edges of the paper, different in that respect also, from the paper in the first four pages.

In addition to the typewriting evidence, and the paper evidence, I examined the characteristics indicating how heavily the characters were struck when the typing was done, and I found that the typewriting in the minutes, the first four pages of minutes, were of uniform pressure and they were what might be termed as average in typing pressure or the force with which the keys were struck.

The last four pages, pages five, six, seven and eight, on the other hand, showed indentations caused by the striking [156] of the keys, indicating that the keys were struck noticeably heavier in the last four pages than in the first four pages, and the last four pages were uniformly heavier and different in that respect from the first four pages.

In addition to that, I found that the indentation of some of the material—

The Court: The what?

A. —the indentation, which is a characteristic of offsetting the margins of typewriting to the left from the—or to the right from the left margin, as would be done in the first line of a paragraph, or in insetting a particular paragraph or section. I am indicating such an indentation on page five of the minutes in question. (Showing Court) The indentation of the paragraphs I am now indicating on page

(Testimony of David A. Black.)

five of the minutes of 10:00 a.m., December 29, 1948 are indented nine spaces, whereas the comparable indentation throughout the first four pages of the minutes illustrated here by the indentations here on page four of the minutes in question was ten spaces rather than nine, as in the last four pages of the minutes.

Q. (By Mr. Archer): I believe you mentioned that there was a certain kind of typewriter which typed pages five to eight of the minutes of 10:00 a.m., December 29, 1948 in Exhibit 15. Now, what kind of typewriter was that?

A. That is a Royal elite typewriter of the period of manufacture, 1945 to 1950, different from the Royal elite type [157] characterizing Royal elite machines before 1945.

Q. Well, with regard to this typewriter which typed pages five to eight, did you examine the minutes to see where in the minutes an exemplar of that typewriter next appeared? A. Yes.

Q. On what date were those minutes written?

A. Those were the minutes of May 18, 1950 where the same type style next appeared in the minutes, in chronological order.

Q. That is the minutes of May 18, 1950 in what is now Exhibit 15, which you have before you?

A. Yes.

Mr. Dinkelspiel: '50 or '51?

Q. (By Mr. Archer): Was that '50 or '51?

A. 1950.

(Testimony of David A. Black.)

Q. Would you check and see whether it is '50 or '51 there? [158]

\* \* \* \* \*

Q. (By Mr. Archer): Mr. Black, I show you what has been marked Plaintiff's Exhibit 26 in evidence in this matter which has been identified as an application for a permit to issue and sell securities by Pacific Rubber Company, on file with the Corporation Commissioner of the State of California, containing a copy of the minutes of the first meeting of the Board of Directors of Pacific Rubber Company at ten a.m. on December 29, 1948.

I believe it shows that it was filed on December 30, 1948, in the San Francisco office.

Have you made an examination of this copy of the minutes of December 29, 1948 at 10:00 a.m. of Pacific Rubber Company?

A. Yes, I made an examination of Plaintiff's Exhibit 26.

Q. Have you had an opportunity to examine the original filed copy of this Plaintiff's Exhibit 26 in the files of the Corporation Commissioner?

A. Yes, I examined it here this morning. [159]

Q. Did you make a comparison between the typewriting shown in this copy of the minutes in Exhibit 26 and the typewriting in the corresponding minutes in the minute book, Exhibit 15, previously shown you?      A. Yes.

Q. For what purpose did you make an examination?

A. For the purpose of determining whether the

(Testimony of David A. Black.)

minutes in the minute book for this meeting, the first meeting, corresponded to the minutes in the Corporation Division copy, especially as to whether they were both typed in the same typing operation simultaneously and one was a carbon copy of the other, or whether something else was true.

Q. And what did you find?

A. I found that the first four pages of the minutes in the minute book were made simultaneously with and at the same time as the carbon copies of the first four pages of this minutes in the Corporation Division copy, Exhibit 26.

The Court: That I don't understand.

The Witness: To state it another way: I found that the first four pages of the minutes in the Corporation Division copy, Exhibit 26, were made as carbon copies made at the same time in the same typewriter as a part of the same typing operation made simultaneously with the first four pages of the original typed minutes in the minute book, the Corporation Division copy being a carbon copy. [160]

The Court: Well, in brief you found that that was a carbon copy, those first four pages of the ones in the minute book?

The Witness: Made at the same time, yes.

The Court: Well, if it's a carbon copy wouldn't it be made at the same time?

The Witness: Not necessarily. It might have been a carbon copy made at a different time of the same material on the same machine. In other words,

(Testimony of David A. Black.)

they are an actual carbon copy made at the same time.

The Court: That's what I call a carbon copy.

The Witness: Thank you, sir.

The Court: One is made at the same time.

The Witness: I found, however, that the other pages did not agree; in the Corporation Division copy of the minutes for that meeting in Plaintiff's Exhibit 26 there are seven pages; in the minutes in the minute book for that meeting there are eight pages.

The Court: I lost you there.

The Witness: In the carbon copy in the Corporation Division set of minutes for that meeting of 10:00 a.m. December 29, 1948, there is a total of seven pages of minutes. That's in the Corporation Division carbon copy. However—

Q. (By Mr. Archer): That is Exhibit 26? [161]

A. 26. However, in Exhibit 15, the minute book, the minutes for that same meeting, 10:00 a.m. December 29, 1948, contain eight, not seven pages of minutes. The minute book contains eight pages; the Corporation Division copy seven pages for the minutes of the same meeting.

Q. Did you determine whether or not any typewritten material appeared in the minutes of the minute book, Exhibit 15, which did not appear in the carbon copy filed with the Corporation Division, which is Exhibit 26? A. Did I find what?

Q. Did you find—did you determine whether or not any typewritten material appeared in the min-

(Testimony of David A. Black.)

utes in the minute book, Exhibit 15, which did not appear in the carbon copy filed with the Corporation Division, Exhibit 26? A. Yes.

Q. What is that material?

A. I found that on page—

Mr. Dinkelspiel: Let me have the question again.

(Record read.)

Mr. Dinkelspiel: That doesn't call for the opinion of this witness, Your Honor; the documents speak for themselves, both available.

Mr. Archer: I think it identifies what we are talking about.

The Court: He may answer. [162]

Mr. Dinkelspiel: Part of the stipulation which I gave you, offered you.

A. I found that the third and fourth paragraphs of page 5 of the minutes in question for 10:00 a.m. December 29, 1948,—

The Court: In which exhibit?

The Witness: In Exhibit 15, the minute book—did not appear anywhere in the corporation division copy of the minutes, Exhibit 26, and I also found that the last three paragraphs at the bottom of page 7 of the minutes in the minute book, Exhibit 25—

Q. (By Mr. Archer): 15.

A. —15, pardon me, and continuing, the first three paragraphs at the top of the succeeding page, page 8 of the minutes in the minute book, Exhibit 15, did not appear in the Corporation Division copy of the minutes, Exhibit 26.

(Testimony of David A. Black.)

Q. Well, so there will be no misunderstanding about it, you are referring to the third and fourth paragraphs on page 5 of the minutes of December 29, 1948?      A. 10:00 a.m.

Q. Pacific Rubber Company, and Exhibit 15. It has been stipulated that Exhibit 8 in evidence is a photostatic copy of those minutes.

For the record, I would like to read those paragraphs at this time. [163]

"The Chairman stated that Article 3, Section 5 of the By-Laws of this corporation provided for the adopting of a resolution designating the time and place of holding regular meetings of the Board of Directors, and upon motion duly made, seconded and unanimously carried, the following resolution was adopted:

"Resolved that regular meetings of the Board of Directors of this corporation shall be held without call on the third Monday of each month at the hour of ten o'clock a.m. at the principal office of the corporation located at 4901 East 12th Street, Oakland, California;

"Provided, however, should said day fall upon a legal holiday, then said meeting shall be held at the same time on the next day thereafter pursuing which is not a legal holiday. Notice of all such regular meetings of Board of Directors is hereby dispensed with."

Mr. Dinkelspiel: Read the other changes, Counsel.

Mr. Archer: You can read them.

(Testimony of David A. Black.)

Q. Now, if I understand your testimony, Mr. Black, those paragraphs I just read do not appear in Exhibit 26?      A. That's right. [164]

\* \* \* \* \*

Q. Mr. Black, do you find in the minutes any other exemplar of the typewriter which typed the last four pages of the minutes in Exhibit 15 of the meeting on December 29, 1948, at ten a.m.?

A. Yes. You want me to describe them? [169]

Q. Yes, please.      A. Or list them?

Q. Yes.

A. In addition to the minutes of May 18, 1950, there are also the waiver and the minutes of July 6, 1950, the waiver and minutes of September 20, 1950, the waiver and the minutes of November 14, 1950, the minutes of January 5, 1951, ten a.m., a notice dated December 26, 1950, which is numbered page 20 in the left upper margin of the minutes, the minutes of January 5, 1951, for eleven a.m., the minutes for January 15, 1951, ten a.m., a resolution of January 15, 1951, accompanying the immediately previously described minutes, and three pages of minutes and two pages of a resolution bearing date May 21, 1951.

Those are—

The Court: Three pages of minutes are what?

The Witness: And two pages of a resolution, both bearing the same date, May 21, 1951. Those are everything that is in the minutes in the minute book.

The Court: Now, finish that statement. Those

(Testimony of David A. Black.)

are everything that are in the minute book—what? That are written by the same typewritten as wrote the last four pages of the—

The Witness: Minutes.

The Court: —minutes of the meeting of [170] December 29, 1948.

The Witness: 1948, at ten a.m.

The Court: At ten a.m., is that right?

The Witness: Yes, sir.

Mr. Archer: Is it stipulated that Exhibit 20 in evidence is a copy of the minutes of May 21, 1951, as they appear in the minute book, Exhibit 15, to which the witness has just referred?

Mr. Dinkelspiel: I would like to ask the witness one question before answering you, purely for clarification. May I?

The Court: Surely.

Mr. Archer: Depends upon the question.

Mr. Dinkelspiel: I want to ask the witness whether, when he testified that the typing was the same as on the last four pages of the minutes of December 28, 1948 in other places, whether you were referring to other places in that minute book which is before you, or was there any other outside documents, say, purporting to be minutes to which you may have referred in one or more instances?

Mr. Archer: I think he referred to consent and waiver—

The Court: Let him answer, please.

The Witness: I was referring only to minutes in the minute book and not to anything outside.

(Testimony of David A. Black.)

Mr. Dinkelspiel: And the minutes in the minute book [171] when you saw it last May?

The Witness: Yes.

Mr. Dinkelspiel: Thank you. [172]

\* \* \* \* \*

The Court: Just a moment. That's the sole purpose of using this photographic evidence is to prove just that fact, that those four pages are different than the four pages that appear in the Corporation file, is that right?

Mr. Archer: And that that typewriter was not again used in the minutes until May 18, 1950. [173]

\* \* \* \* \*

Q. Mr. Black, I would like to invite your attention to the last page of the minutes of the first meeting at 10 a.m., December 29, 1948, in the minute book, Exhibit 15; inviting your attention to the page bearing the signatures of Orris R. Hedges and V. Hendricks—

The Court: Mr. Reporter, read that question back.

(Pending question read back by reporter.)

Q. (By Mr. Archer): Did you examine these signatures with relations to the other signatures of these individuals which appear on documents dated the same date in the minute book?

A. Yes. [176]

Q. What did you find?

A. I found that there are a number of other places in the minutes book, Exhibit 15, in different places where the signatures of these same two

(Testimony of David A. Black.)

people appear all purporting to be made on the same date, at least that's the date on the document, and in none of—

Mr. Dinkelspiel: Wait a second, please. Would the witness please point those places out?

The Court: Let him finish his answer. Go ahead and finish it.

A. In none of those other places were the same inks used in their signatures as was used in the signatures of those two persons on the last page, page 8 of the minutes in question.

Mr. Dinkelspiel: Now, may I ask the witness to point out those places?

The Court: No, you may do that in cross-examination. Let's go ahead.

Mr. Dinkelspiel: O.K.

Q. (By Mr. Archer): Did you find anything else on this same last page of these minutes of December 29, 1948, at 10 a.m., in minute book Exhibit 15, which appeared to be of significance?

A. Yes.

Q. What did you find?

A. Are you referring to whether or not the page had any evidence of being mailed out? [177]

Q. Well, yes, if that is what you found.

A. Yes, I found evidence characteristic of papers sent through the mail.

Q. What were those characteristics?

A. I found that the page had been folded in three horizontally, as is done on letter size pages, folded to enclose in regular business envelopes, and

(Testimony of David A. Black.)

that none of the other pages in the minutes or waiver of that same date had been so folded. I found that the page—

The Court: What date are you talking about now? A. December 29, 1948.

The Court: All right.

A. Ten a.m., the page I am pointing to.

The Court: Which have folds and which do not?

A. The last page bearing the signatures, page 8, has folds.

The Court: This one? A. Yes.

The Court: Just a minute, let me—. Go ahead and finish your answer, sir.

A. But that none of the other pages have such folds, and then there is other evidence as well.

The Court: Now, this page here that you are showing me now, that is marked page 8, what folds are you referring to?

A. I am referring to the folds going horizontally through the upper third of the page and horizontally through the lower [178] third of the page.

In addition to the folding, I found that the page, that same page, contains considerable crinkling, such as characteristic of papers that I have seen crinkled going through a mail slot.

In addition to that, I found that it had a paper clip mark, which I have found to be characteristic of many documents sent as enclosures with a letter of transmittal.

And in addition to that, I found that there was the remains or vestiges of the initials "ORH,"

(Testimony of David A. Black.)

is a copy of what appears in Exhibit 15 on that date and time.

Mr. Dinkelspiel: Wait a second (examining document). What date are you referring to?

Mr. Archer: January 15. He might have the wrong exhibit there, counsel. January 15, 1951, at 10 a.m.

Mr. Dinkelspiel: The witness inadvertently turned the page.

Mr. Archer: It is Exhibit 16.

Mr. Dinkelspiel: I see it now.

Mr. Archer: That does not include the resolution he was talking about but it does include the minutes.

Mr. Dinkelspiel: I will stipulate with counsel that Exhibit No. 16 is a copy of the minutes which appear as both [181] minutes of regular meeting of Board of Directors of Pacific Rubber Company, and then the date is January 15, 1950—but I want the record to show—

The Court: '50?

Mr. Dinkelspiel: January 15, 1951—but I want the record to show that the second two pages the witness was referring to were entitled "Certified copy of resolution of Board of Directors of Pacific Rubber Company" as distinguished from the first two pages being "Minutes".

Is that stipulated, counsel?

Mr. Archer: Yes. The certified copy is the one that has the handwriting "Regular" over the word "Special".

(Testimony of David A. Black.)

Mr. Dinkelspiel: And which the witness says was on a different typewriter than the minutes. What that proves, I don't know.

The Witness: My testimony was on the same typewriter but at a different time.

Mr. Dinkelspiel: Pardon me, I didn't misquote you intentionally. I ask the same question: What difference?

Q. (By Mr. Archer): Now, Mr. Black, directing your attention to the two pages of minutes of the regular meeting or what purports to be a regular meeting of the Board of Directors held at 10:30 a.m., January 15, 1951, in Exhibit 15, did you examine those two pages to determine if there were any different conditions at that time? [182]

A. Yes.

Q. What did you find?

A. I found that while both of the two pages of those minutes were typed on the same typewriter, they were typed at a different time on the same typewriter as indicated by the darkness of the ribbon impression made on them. [183]

\* \* \* \* \*

#### Cross Examination

Q. (By Mr. Dinkelspiel): Mr. Black, just by way of introduction you had this minute book in your possession for several days during the month of May, I understand? A. Yes.

Q. And it was delivered to you by whom?

A. By Mr. Bouchard.

Q. Do you know who Mr. Bouchard is?

(Testimony of David A. Black.)

A. Yes.

Q. One of the attorneys for the plaintiff in this action, [184] isn't that correct?

A. I am not sure I knew it at the time, but I know it now.

Q. Yes. You said you had it in your possession how long?

A. I examined it on five different days, and I imagine I may have had it a day or so more.

Q. You don't know how long—

A. About a week.

Q. You don't know how long Mr. Bouchard had it in his possession? A. No.

Q. You testified this morning, part of your testimony, that you had gone through that book, you noticed where there was evidence of clip marks.

A. Yes.

Q. That's right. I don't want to misquote your evidence, — as if something had been clipped together and mailed, I think you said.

A. I stated, I believe, that many pages had clip marks and clip marks are one characteristic of a document that has been mailed with a letter of transmittal.

Q. Clip marks, though, are characteristic of other things? A. Oh, yes.

Q. Instead of dogearing a page, for example—you know what I mean by dogearing, don't you?

A. Folding over. [185]

Q. Yes.

A. And tearing it in lieu of paper-clipping it?

(Testimony of David A. Black.)

Q. That's right. A. Yes.

Q. You mentioned paper-clipping; that is quite customary in marking a page for further reference, isn't it? A. Yes, I suppose it is.

Q. You don't mean to testify, of course, that you could tell the difference between that sort of a paper clip mark and a paper clip mark that is sometimes identified with mailing? A. No.

Q. And you are not so testifying now?

A. Well, to this extent, that sometimes the position of a paper clip mark will indicate whether it was used to attach two papers together or to mark a certain paper or section of a paper for identification.

Q. You mean the position of a clip mark will do that? A. Yes.

Q. Well, is there a set position in your mind for clip marking for identification purposes?

A. No, but there is a characteristic position for one clipping one paper to another for sending through the mail or other purpose.

Q. I see. But could you testify under oath—

The Court: How is that? [186]

The Witness: That is on the top side of the paper toward the left hand corner.

The Court: Have you ever seen it done on the top side of the paper toward the right hand corner?

The Witness: Occasionally, yes.

Q. (By Mr. Dinkelspiel): Now, Mr. Black, I think you testified that you examined this book and you also examined, I believe, a photostatic copy of

(Testimony of David A. Black.)

minutes of a meeting of December 28, 1948 that were filed with the Corporation Commissioner, or a photostatic copy, is that correct? A. Yes.

Q. Did you examine any other documents in this case other than the book and the copy of the minutes of that meeting?

A. No, just the minutes in the book, that is, everything in the book, Exhibit 15; everything in the certified copy, photostatic copy of the material filed with the Division of Corporations and Secretary of State, and the originals of the material filed with the Division of Corporations.

Q. Nothing else?

A. Nothing that I recall now.

Q. No other letters?

A. No, I don't recall any at all.

Q. No other copies of minutes?

A. No, not that I recollect now.

Q. Would you recollect if you had? [187]

A. I would think I would remember them, and I don't remember having examined any others now.

Q. So we can say quite positively, then, you didn't examine any other documents?

A. Fairly positively, yes.

Q. I think you said, did you not, that—I will start that over again.

You identified the first four pages of the organization minutes, those minutes of December 1948, as having been made by one typewriter and the last four pages by another. A. Yes.

Q. You also identified, did you not, the type of

(Testimony of David A. Black.)

typewriter that was involved? A. Yes.

Q. Two types, were there not? The first four pages by what kind of a machine?

A. Royal elite before 1945.

Q. Royal elite before 1945. And the second type by what?

A. Royal elite 1945 to 1950.

Q. All right. Then you identified certain minutes beginning with May 18, 1950, the minutes of a meeting, as having been made by a Royal elite since 1945?

A. Yes, the same sort of a machine, Royal elite 1945 to 1950.

Q. I want to ask you a question: Did you testify, or do you [188] now testify that the minutes of May 18, 1950, were made on the same machine as the minutes of the last four pages of the organization meeting in 1948?

A. What was the date of the May minutes?

Q. May 18, 1950. A. Yes.

Q. Your answer is that that is the same machine? A. Yes.

Q. And you deduce that from what?

A. From the fact that, first of all, that the make, the type style and the manufacture period characteristics of the type are the same, which means it is the same make, model and age of machine.

Q. Yes.

A. And secondly, there are certain identifying characteristics which are characteristic of individ-

(Testimony of David A. Black.)

ual machines that appear in both. I don't recall all of them now, but—

Q. What do your notes show on that?

A. My notes show that the two machines are the same, and I have just checked it against one or two of the characteristics and I find that, here and now, my notes are confirmed which were the result of my first examination.

Q. Now, will you proceed to the minutes of the —to the waiver and minutes of July 6, 1950. I will ask you the same question, whether that is the same machine. [189]

A. Yes, my notes show it is the same machine, and this reexamination shows there are characteristics which are the same.

Q. Can you come to that kind of a conclusion without too extensive an examination? I mean, if I were to show you something that might be written on that or another machine and ask you to compare it, could you reach any conclusion?

A. I might be able to. I am not basing my present statement—

Q. I know that.

A. —on the examination here, but principally on my previous examination. I might be able to do it, I don't know.

Q. I am not questioning your previous examination, just asking for the information. If I were to show you a document can you with a fair degree of accuracy tell me whether it was the same machine?

(Testimony of David A. Black.)

A. Well, it might take 15 or 20 minutes.

Q. I see. Could you tell whether it was the same type of machine?

A. I could say almost immediately if it were a different machine.

Q. Fine.

A. If it were a different make, model or type style. [190]

\* \* \* \* \*

Q. Let me ask you this question: There was a different typewriter used, and you have so testified, for the first four pages of the 1948 minutes; right?

A. Yes.

Q. Have you looked through that book to determine where, if anywhere, the same typing appears, or work of the same typewriter appears?

A. Yes. [191]

Q. May we have that, please?

A. In the waiver, for the same minutes—I beg your pardon. I may have previously mentioned that; yes, the waiver for the same minutes, 10 a.m. meeting of December 29, 1948, and in the order, in chronological order the waiver for the 2 p.m. meeting of the same date and for the 4 p.m. meeting of the same date, the waiver, and for the minutes of the 2 p.m. meeting of the same date, and for the first page of the minutes for the 4 p.m. meeting, but not the second page.

Q. Let's get that. The 4 p.m. meeting on the 28th?

A. On the 29th of December, 1948.

(Testimony of David A. Black.)

Q. There are two pages there and you say it is the first page or the second page?

A. It is the first page that was written on the same kind, the same typewriter, as was used to produce the first four pages of the minutes of the 10 a.m. meeting.

Q. And just so we know what the differential is, the second page consists only of the following: "Upon motion being duly made, seconded and unanimously carried the foregoing resolution was adopted. There being no further business to come before the meeting, by motion duly made, seconded and unanimously carried the meeting was adjourned." And signed. Is that a different typewriter than the first page?

A. No, those are the 2 p.m. minutes; I am referring to the 4 p.m. minutes. [192]

Q. My mistake. What about the waivers, notices, the resignations—are they the same?

A. The resignations are on the same typewriter, Royal elite before 1945.

Q. The same typewriter?

A. Yes, as was used to type the first four pages of the 10 a.m. minutes.

Q. I see. In this meeting at 4 o'clock, is the waiver on the pre-1945 typewriter?

A. The waiver of—accompanying the 4 o'clock minutes is typed on the same pre-1945 typewriter. The minutes, the first page of the 4 o'clock minutes were typed on that same typewriter, but the second page was not.

(Testimony of David A. Black.)

Q. I seem to be a bit lost here.

Now, which 4 o'clock meeting are you referring to? Are there two sets of minutes of the 4 o'clock meeting?

A. One.

Q. My mistake. All right. Will you find for me, please, the waiver of the 4 o'clock meeting?

A. Yes.

Q. You have pointed to a consent and waiver and you say that is on the pre-1945 typewriter?

A. On the pre-1945 typewriter.

Q. And the first page of the minutes is on the pre-1945 typewriter? [193]

A. Yes.

Q. The second page is on the subsequent one?

A. No, that is on an entirely different one.

Q. Entirely different. All right. Is this the first place in the minute book where a third type of typewriter comes in, starting chronologically?

A. Yes, that is the first page in the minutes where a third typewriter chronologically appears.

Q. What is that type?

A. That is an IBM, an International Business Machines elite typewriter.

Q. That's a different typewriter altogether?

A. Yes.

Q. Now, continuing through the minutes, will you show us, please—you have already showed us where the pre-1945 Royal is in—will you go through the minutes and show us where your examination discloses the other one or two typewriters as having typed the document?

(Testimony of David A. Black.)

A. You mean show where both the pre-1945 Royal machine and the IBM machine?

Q. Yes, or any other machine excepting only the subsequent 1945 Royal. A. Yes.

Q. That you testified about.

A. I have just mentioned that the second page of the minutes [194] for the 4 p.m. meeting of December 29, 1948, are on an IBM elite; that's the first instance of IBM.

Q. Right.

A. Then there is a waiver and two pages of minutes for a meeting of March 18, 1949, which is written on the same—which are all written on the same IBM elite typewriter as was used to produce the minutes, the second page of minutes for the 4 p.m. meeting of December 29, 1948, previously referred to.

Q. That is a meeting of March—

A. —18, 1949.

Q. 1949. And the waiver of that meeting, right?

A. Yes.

Q. The next is the meeting of 18 May 1950, which you have testified to as being made on the subsequent to 1945 elite; right? A. Right.

Q. And the waiver for that? A. Yes.

Q. The next meeting of 6 July 1950, I think you have already testified as to that, haven't you?

A. Yes.

Q. That was the subsequent to 1945 Royal?

A. Yes.

Q. Waiver the same thing? [195]

A. Yes.

(Testimony of David A. Black.)

Q. Minutes of September 20, 1950 and the waiver?

A. On the same after 1945 Royal elite.

Q. The minutes of 14 November 1950 and the waiver?

A. Yes, on that same later Royal elite.

Q. The 5th of January, 1951, 10 o'clock, I think you told us was on the later Royal elite, is that right? A. Yes.

Q. How about the call to that meeting? Want to look at it in the book, or do you have your notes on it?

A. What is the date of the call?

Q. Well, it is for a meeting on January 5, 1951, dated the 26th.

A. That's on a still different IBM machine; it is on a second IBM.

Q. On a second IBM? A. Machine.

Q. That brings a fourth machine into the discussion, does it not? A. Yes.

Q. Now, will you look at the next page, which seems to be—no, I withdraw the “seems to be”—the next page says notice of special meeting of Directors, likewise dated December 26, looks like a call to me. Can you tell what machine that was on?

A. That's on the same IBM elite as made the call to which it corresponds, that is, the fourth machine, the second IBM elite machine.

Q. Now then, the meeting of the 5th day of January, 1951, special meeting of shareholders, 11 o'clock meeting— A. 11 o'clock meeting.

(Testimony of David A. Black.)

Q. ——I think you said was a later Royal?

A. That is correct.

The Court: Wait a minute. 10 o'clock a.m.?

The Witness: No, 11 o'clock meeting he was referring to.

The Court: Did you skip the 10 o'clock meeting?

Mr. Dinkelspiel: If I did I did it unintentionally.

Mr. Archer: What date is that?

Mr. Dinkelspiel: January 5. January 5, 1951. I think he testified that was also the Royal—was it not?

The Witness: 10 o'clock meeting, yes, and the 11 o'clock meeting, too.

Q. (By Mr. Dinkelspiel): And this call of this meeting I think you said was a different machine, or am I wrong?

A. Yes, that's a different machine.

Q. The second IBM? A. Yes.

Q. And this copy, notice of a special meeting, this notice dated December 26, 1950, what is that?

A. Is that the one that you previously asked me about, the carbon copy? [197]

Q. Yes.

A. You previously asked me about?

Q. I think so.

A. That is on the second, different IBM machine.

Q. Now, we have the second meeting, or rather the stockholders meeting of January 5, 1951, at 11 o'clock. That is the second Royal, is it not?

(Testimony of David A. Black.)

A. Yes, that is the Royal elite 1945 to '50.

Q. All right. Now, there is a certified copy of a resolution that I think you said is the same machine you just mentioned?

A. No, I haven't mentioned that; that is on the second IBM elite machine.

Q. I see. And also the affidavit dated the 26th day of December, 1950?

A. That is also on the second IBM elite.

Q. All right. There is a call of a special meeting of shareholders dated the 26th day of November, 1950, signed John Condrey; what machine is that? A. On the second IBM elite.

Q. And the minutes of special meeting of shareholders dated December—no. Notice of special meeting of shareholders dated December 22nd, 1950, is that that second IBM elite? What would you say that was? [198]

A. May I refer to page numbers on the book?

Q. Yes.

A. That would be much simpler.

Q. Certainly.

A. That was written on the later Royal elite.

Q. This one? The notice of special meeting.

A. Yes.

Q. And the affidavit of mailing notice of special meeting?

A. That's on the second IBM elite.

Q. Now, we have minutes of—I think you testified that this 15th day of January 1951 certified copy of resolution was what? Your page 17 and 18.

(Testimony of David A. Black.)

A. That is on the second Royal elite.

Q. And the minutes of that same meeting, of the meeting in which the resolution was adopted, which is your page 15 and 16 and dated January 15, 1951?

A. That is on the second Royal elite, just as is the resolution.

Q. All right. Now, the minutes of regular meeting of Board of Directors January 15, 1951, 10:30 a.m., your pages 13 and 14.

A. Those are written on a third IBM elite.

Q. Another one?      A. Another one, yes.

Q. We have a certified copy of resolution of Board of Directors, [199] unsigned, dated the 22nd June, 1951, your numbers 11 and 12.

A. That is on the same third IBM elite.

Q. Minutes of meeting on the 18th day of May, 1951, your numbers 9 and 10.

A. That's on the same third IBM elite.

Q. Must have bought a new typewriter at that time, didn't they? There is a waiver of notice dated May 17, 1951, which is this?

A. That is on the third IBM elite.

Q. I see. Then there is a regular meeting, so-called, the Board of Directors of Rubber Company, dated May 21, 1951, your pages 6 and 7?

A. That's a resolution.

Q. Certified copy of resolution.

A. Yes. That is written on the later Royal elite previously mentioned.

Q. Later Royal elite. Now, then a meeting, min-

(Testimony of David A. Black.)

utes of a regular meeting of Board of Directors, which is dated May 21, 1951, 10 o'clock; what was that written on?

A. On the later Royal elite.

Q. Did you have occasion to examine this minute book, the Articles of Incorporation that appear therein? A. Yes.

Q. What was that written on? [200]

A. That was written on the first IBM elite that I mentioned.

Q. First—pre-1945?

A. No, I didn't specify any day as to the IBM elite.

Q. I beg your pardon. IBM elite?

A. Yes.

Q. Not upon the Royal? A. No.

Q. How about the by-laws — did you look at them? A. Yes.

Q. What machine were they made on?

A. They were made on two different machines.

Q. Divided how?

A. Certain non-consecutive pages were written on the Royal elite, 1922, or, that is, pre-1945.

Q. Yes.

A. Which I have previously mentioned and certain others not consecutive pages were written on the later Royal elite, 1945 to 1950.

Q. I hand you, Mr. Black, a series of documents which are together in Plaintiff's Exhibit No. 7. First is a letter from Mr. John B. Condrey to Mr.

(Testimony of David A. Black.)

Glenn A. Taylor, dated January 26, 1951, and ask you if you have ever seen that before?

A. No.

Q. Would it be possible for you to tell us on what machine [201] that letter was written?

A. It is on a Royal elite of the later vintage, 1945 to 1950. If you wait just one moment, I will check to be sure. Yes, that is correct, it is written on a Royal elite 1945 to 1950. [201A]

Q. (By Mr. Dinkelspiel): Would you say the same typewriter wrote the second four pages, the minutes of December 28, 1948, or is that asking too much of you from this observation?

A. I can try to answer it.

Q. All right, sir, will you?

A. (Witness examining document) I can't make a definite statement now in this examination, but I note that it is—the letter you have shown me, Plaintiff's Exhibit 7, the top document—is the same—shows the same brand and style and vintage of type as the last four pages of the minutes of ten a.m. December 29, 1948, and in addition has, I have observed, some individually identifying characteristics which to me make it seem probable that the two are typed on the same machine.

Q. Would it indicate as to who did the typing?

A. Would what indicate?

Q. I mean your examination of the two documents, the last four pages of the minutes of 1948, and this letter, would it give you any clue as to whether the same typist did it?

(Testimony of David A. Black.)

A. I haven't examined it for that purpose.

Q. You have not examined any of these documents for determination of the similarity of typist or identity of typist? A. No, I haven't.

Q. Is that possible to do?

A. It sometimes is. But I am not sure whether it is or is not possible in this case. [202]

Q. Now here is attached to this document a so-called waiver, the document I am talking about is Plaintiff's Exhibit No. 7, purportedly signed by three directors, Mr. DeSellem, Mr. Taylor and Mr. Condrey, and dated the 14th of January, 1951, and relating to a meeting to be held January 15, 1951.

Have you ever seen that before?

A. Was it ever in this minute book?

Q. As a blank piece of paper I think it was in the minute book, but I don't think it ever came back filled in, at least after it was sent east.

Mr. Archer: Do you wish to testify, Mr. Dinkelspiel?

Mr. Dinkelspiel: He asked me a question, and to my knowledge it was produced in court by the plaintiffs in this action.

A. I can't see the absence of a number in the upper left hand corner here, which enables me to testify that it was not in the book when I examined it, and I have never examined it before.

Mr. Dinkelspiel: Could you tell what typewriter that was on?

A. (Examining.) I will make the same statement about it, that the second sheet of paper from

(Testimony of David A. Black.)

the top in Plaintiff's Exhibit 7, that I made about the first sheet of paper, it is the same make, model and vintage of typewriter, it has the same type style, and it has some individually identifying [203] characteristics, which lead me to believe it is probably the same typewriter as typed the first page of Exhibit 7 and the last four pages of the minutes of ten a.m. December 29, 1948.

Q. Will you say the next document appearing, also entitled "Waiver and Consent to the holding of special meeting of Board of Directors of Pacific Rubber Company," is or is not a contemporaneous carbon with the last page that you testified about?

A. (Examining.) Yes, it appears to me here to be a carbon copy made simultaneously.

Mr. Dinkelspiel: I would like to follow Mr. Archer's suggestion and ask you, Mr. Clerk, to letter these pages so that we know what he is referring to.

The Court: Is this Exhibit 7?

Mr. Dinkelspiel: This is Exhibit 7. Just so we know what page we are referring to.

The Court: All right.

(The pages to Exhibit 7 lettered A to I, inclusive.)

Q. (By Mr. Dinkelspiel): Just so the record can be clear, the first document you testified about under Plaintiff's No. 7 is now marked 7-A, is it not? A. Yes.

Q. And the second document is 7-B?

A. Yes. [204]

(Testimony of David A. Black.)

Q. And the third document, the carbon, is 7-C?

A. Yes.

The Court: They are all on the same typewriter?

A. That's my best judgment.

The Court: And that's the second Royal?

A. Yes.

Q. (By Mr. Dinkelspiel): Now, there is 7-D. I think you may find this in the minute book—I am not sure—the meeting of January 15, 1951—I'm not sure.

Mr. Archer: Special meeting?

(Witness examining documents.)

Mr. Dinkelspiel: I think I misled you. I don't think that is in the minute book.

A. Just a moment (examining minute book). Well, I don't know where it is.

Mr. Archer: Where is that certified copy that has "Special" changed to "Regular" on it?

Mr. Dinkelspiel: Here.

Mr. Archer: That's a certified copy. I guess that isn't it.

Q. (By Mr. Dinkelspiel): Anyway, could you tell us which machine typed this original of this carbon 7-D?

A. (Examining) It is of the same Royal elite style of 1945 to 1950 as the others, the second Royal elite. I am not sure whether it is the identical machine or not. It may be but— [205]

Q. At any rate— A. I can't tell.

Q. It is the same type of machine that typed the last four pages of the 1948 organization minutes?

(Testimony of David A. Black.)

A. Yes.

Q. 7-F, which is—I do think you will find this in the minute book—January 15, 1951—

The Court: What happened to 7-E? Did I miss that?

Mr. Dinkelspiel: Pardon me, sir. 7-E is the second page of the last instrument.

The Court: I see.

(Witness examining.)

The Witness: What is the question here?

Mr. Dinkelspiel: My question is what is the typewriter that typed the original 7-F? If I misled you, I want to withdraw it. I thought this was a carbon of the one in the minute book, but it does not appear to be it.

A. No, it's definitely not.

Q. Yes. A. Do you wish to know the—

Q. The type similarity.

A. The type of machine it is?

Q. Yes.

A. (Examining) It is an IBM elite.

Q. IBM elite? [206] A. Yes.

Q. You don't know which one of the three IBM's, if any of those that you testified to, it is?

A. No, I don't.

Q. 7-G is the second page of that, your Honor.

7-H—I will ask you whether 7-H was typed, as far as you can determine, on the same typewriter as 7-A, which I believe you stated was the later elite?

A. (Examining) Yes, it appears to be on the same Royal elite of later date.

(Testimony of David A. Black.)

Q. And the final one is 7-I, which may or may not be identical with 7-F. No, it isn't. I will ask you about 7-I. Can you identify the typing on that?

A. (Witness examining) It is on an IBM elite also.

Q. I see. Thank you very much.

Now, just a few more questions. You did state that the signatures of Mr. Hedges and Miss Hendrickson appearing on the page we have numbered 8 in the meeting of December 29, 1948, was in different ink than the signature appearing elsewhere of meetings of the same date? A. Yes.

Q. In other words, Mr. Hedges' signature here is blue and elsewhere it is black, in one differential, is that correct? A. Yes.

Q. And Miss Hendrickson is a lighter blue than previous—— [207] A. Yes.

Q. —than in others? A. Yes.

Q. You did testify, did you not, that in your opinion—it was your conclusion that this last page might have been mailed because it showed the folding marks and evidence of having been handled, is that correct? A. Yes.

Q. I think you stated, and if I misstate you, please correct me, that there are other pages in the minute book which appeared to have been mailed or—mailed, I think it was—or removed from the minute book or something of that kind; do you recall your testimony in that respect?

A. I think I said that there are other pages that had paper clip marks on them.

(Testimony of David A. Black.)

Q. Well, we have been over the paper clip. We don't have to repeat that. But did you notice any other pages, such as—particularly signature pages—that appeared to have been mailed? I don't mean to take the book from you in case you need it.

A. That's all right. I don't think I so testified.

Q. Did you make examination for that fact?

A. Yes.

Q. And what are your conclusions?

A. I believe I testified that there were no minutes that [208] had all of those conditions. That some minutes had some paper clip marks, but that no minutes had crinkling or creased initials or folding. There were other documents that did have paper clips, some of them crinkling, some of them the horizontal folding, and some of them erased material, but not of the same type of material as on page 8 of the questioned minutes of ten a.m., December 28, 1949.

Do you wish—

Q. The same type of material? What do you mean by that?

A. Well, there was no other place, first of all, where there were erased names or initials that were originally red pencil. There was some graphite or ordinary lead pencil erasures.

Q. Not to interrupt you, but isn't all you are telling His Honor and us is that there were in places throughout these minutes markings in red pencil or ordinary graphite with the initials of the

(Testimony of David A. Black.)

person who was to sign, isn't that what you are stating?

A. No, I think the effect of my testimony is that nothing else in this book was handled exactly like this page 8 of the minutes.

Q. All right. Explaining that, you told us that there were some graphite or red pencil marks, initials?

A. I stated that page 8 of the questioned first meeting minutes had red pencil initials erased. That is not true of any other page in the whole book.

Q. No, you are not questioning the signatures of the two signers on page 8, are you?

A. Questioning them in what way?

Q. As to their authenticity? A. No.

Q. And what conclusion are you trying to have us reach with respect to red pencil marks instead of graphite pencil marks?

A. Nothing except that this particular page was handled in a different way and that that is one of the characteristics of documents that are mailed out for signature.

Q. Well, now, what is this mailing business, when two people aren't in the same towns, sometimes we have to mail, don't you? A. Yes.

Q. Let me call your attention—just open the book a minute—waiver, March 18, 1949, are there any mailing marks on that? A. What marks?

Q. Mailing marks.

A. Well, I have that listed as having an erasure of the name Glen A. Taylor, which was originally

(Testimony of David A. Black.)

written in graphite pencil to the left of the name and erased.

Let me see if I have anything else on it. (Examining.) It also is crinkled and it also is folded in three [210] horizontally. That is a waiver and consent.

Q. In other words, your conclusion with respect to this page would be, would it not, that it was mailed to someone for signature? A. Yes.

Q. And that the name of the person signing his name was written in pencil to show him where to sign? A. Yes.

Mr. Dinkelspiel: Thank you. That is all.

\* \* \* \* \*

#### GLEN A. TAYLOR

called as a witness on behalf of the Plaintiff, sworn.

The Court: State your name, please.

A. Glen A. Taylor.

#### Direct Examination

Q. (By Mr. Herndon): Where do you reside, Mr. Taylor? A. In Tuscumbia, Alabama.

Q. What is your occupation?

A. I am Vice President of Robbins Tire & Rubber Company, Incorporated.

Q. How long have you been Vice President of [211] Robbins Tire & Rubber Company, Incorporated? A. For a little over ten years.

Q. Where is the main plant of Robbins Tire & Rubber Company?

A. It is located in Tuscumbia, Alabama.

(Testimony of Glen A. Taylor.)

Q. Would you tell us briefly a little bit about the business, who was president of the corporation?

A. Mr. Poncet Davis was president.

Q. And who was active operating head of the corporation?

A. I am active operating head of the company in Tescumbia.

Q. What are your functions? What are your duties as vice president of the Robbins Tire & Rubber Company, Incorporated?

A. I have over-all responsibility for the sales and for the office administration.

Q. Does the Robbins Tire & Rubber Company maintain an office other than in Tescumbia, Alabama?

A. Mr. Davis maintains his office in Akron, Ohio, as president of the company. The general offices and manufacturing plants are in Tescumbia.

Q. What does Robbins Tire & Rubber Company, Incorporated, manufacture, please?

A. We manufacture inner tubes, tread rubber for retreading of tires, tire repair materials, small tires for wheel toys such as coaster wagons, tricycles, rubber and vinyl plastic floor tile, wall tile, and all floor covering accessories.

The Court: All what? [212]

A. Floor covering accessories, such as cold base that goes on the wall and cold base corners, various accessories that are used with floor covering. Our sales are in excess of one million dollars per month.

Q. (By Mr. Herndon): Mr. Taylor, does the

(Testimony of Glen A. Taylor.)

Robbins Tire & Rubber Company, Incorporated, have an engineering department?

A. Yes, we do. That is headed up by Mr. Stanley Robbins, one of our vice presidents, who has charge of engineering and production.

Q. Are you familiar with the company known as Pacific Rubber Company? A. Yes, I am.

Q. Will you tell the Court, please, how you obtained that familiarity?

A. I was a director of the Pacific Rubber Company.

Q. Have you ever been an officer of Pacific Rubber Company? A. No, I never have.

Q. And tell us, if you know, Mr. Taylor, when you first became a director of Pacific Rubber Company?

A. Why, it was in December, 1948, I believe.

Q. And for the period subsequent to December, 1948, when you were elected director, a director of Pacific Rubber, did you serve in that capacity down to the present time?

A. Yes, I served in that capacity. I have never been notified that I am no longer a director. [213]

Q. Can you tell us who the directors were of Pacific Rubber Company, the names?

A. Yes. It was Mr. DeSellem and Mr. Condrey and myself.

Q. Do you know whether an individual by the name of Earl Booz was ever a director of Pacific Rubber?

A. No, he was never a director.

(Testimony of Glen A. Taylor.)

Q. Now, Mr. Taylor, I would like to refer to the period from December, 1948, when you testified you became a director of Pacific Rubber, up to January the 1st, 1951, and may I ask you whether you were ever notified during that period that I have just mentioned by Pacific Rubber or any other officers as to a time for holding directors' meetings or that a director's meeting would be held at a given time? A. Yes, I was.

Mr. Dinkelspiel: May I have the time the period covered, Mr. Reporter?

The Reporter: From December, 1948 up to January the 1st, 1951.

Q. (By Mr. Herndon): To your knowledge, from December, 1948, when you became a director, up to January the 1st, 1951, were you notified of all directors' meetings held during that period?

A. I was notified of what I assume to be all of them. I was notified frequently of meetings.

Q. Now, Mr. Taylor, can you tell the Court the last time [214] you attended a directors' meeting of Pacific Rubber Company?

A. I attended a directors' meeting on January 5, 1951. That was the only directors' meeting I attended.

Q. Mr. Taylor, I hand you what has been admitted in evidence as Plaintiff's Exhibit 7. Have you ever seen that document marked Plaintiff's Exhibit 7 before? A. Yes, I have.

Q. Can you tell the Court where that document came from, that is, Plaintiff's Exhibit 7?

(Testimony of Glen A. Taylor.)

A. This document came from our files in Tescumbia, our general files.

Q. And where did you receive the document from?

A. Where did I receive it from?

Q. Yes, where did you obtain the document?

A. I obtained it in late January, 1951.

Q. And from whom, please?

A. From Mr. John B. Condrey, through the mail.

Q. Now, Mr. Taylor, as to the date of the receipt of Plaintiff's Exhibit 7 in evidence, thereafter did you receive any other communication from the Pacific Rubber Company, any officer of Pacific Rubber Company, or any director of Pacific Rubber Company, with respect to any meetings or any business whatsoever?

A. I did not. This was the last communication I ever received from them. [215]

Q. Mr. Taylor, may I ask you, are you generally familiar with the contract which has been referred to in these trial proceedings as the Minnesota Synthetic contracts for the operation of certain synthetic rubber plants at Torrance, California?      A. Yes, in a general way.

Q. Do you have any knowledge as a director of Pacific Rubber Company when Pacific Rubber Company first acquired an interest in that contract identified as the Minnesota contract?

A. Why, it seems to me that was in late 1950.

Q. Were you ever present at any directors'

(Testimony of Glen A. Taylor.)

meeting of Pacific Rubber Company, as far as that goes, any stockholder meetings of Pacific Rubber Company, when that contract was discussed?

A. No, that contract was never discussed at the directors'-stockholders' meeting I attended.

Q. Mr. Taylor, going in the period now from January the 1st, 1951 up to the present, may I ask you, have you attended or have you been notified of any directors' meeting during that period just mentioned, that is, directors' meeting of Pacific Rubber Company?

A. That was the period from January 1st, 1951 up until the present time?

Q. Yes.

A. One meeting only, on January 5. [216]

Q. On January 5 of which year? A. 1951.

Q. As vice president of Robbins Tire & Rubber Company, Incorporated have you been notified of any stockholders' meeting of Pacific Rubber Company, for the same period, that is, from January 1st, 1951, up to the present?

A. Only one, that was on the same date, January 5, 1951.

Q. I take it, after January 5, 1951, you received no further notice of any directors' meeting?

A. No, I did not. That was the last meeting I knew anything about.

Q. Did you attend a stockholders' meeting on January 5, 1951? A. Yes, I did.

Q. And you also attended a directors' meeting?

A. That's right, I attended both of them.

(Testimony of Glen A. Taylor.)

Q. Who was present, Mr. Taylor, if you know, at the directors' meeting of Pacific Rubber Company held on January 5, 1951?

A. Well, it seems to me that present were Mr. DeSellem, Mr. Condrey, Mr. Pauley, Mr. Hedges, Mr. Bouchard, Mr. Davis and myself.

Q. Will you tell us, please, who was present at the stockholders' meeting that you attended on January the 5th, 1951, again if you know? [217]

A. It seems to me that it was the same personnel, with the exception that I do not believe that Mr. DeSellem was present, but I believe Mr. Booz was present.

Q. What was Mr. Booz's capacity with Pacific Rubber at the time?

A. He was, I believe, executive vice president or vice president, one or the other. [218]

\* \* \* \* \*

Q. Mr. Taylor, at any time during the course of the time you have served as director of the Pacific Rubber Company, have you ever given consent to the transfer of a contract known as the Minnesota contract for the operation of certain synthetic rubber plants at Torrance, California, any individual or any company or corporation?

A. Definitely not.

\* \* \* \* \*

Q. (By Mr. Herndon): Mr. Taylor, did you have knowledge that the so-called Minnesota contract was transferred by Pacific Rubber Company?

A. The first time that I had knowledge that

(Testimony of Glen A. Taylor.)

that contract had been transferred was in late 1942, or possibly early 1953.

Q. Is that 1942? [219]

A. 1952; late 1952 or early 1953.

Q. Very well. How did you obtain knowledge that the so-called Minnesota contract had been transferred by or sold by Pacific Rubber Company?

A. The first I ever heard of it was in a telephone conversation from Mr. Davis in Akron, Ohio, who called me at the plant and wanted to know if I knew anything about it, and asked me if I had signed anything to the effect. I told him I had not and that it was news to me, the first I had ever heard of it.

Q. What was the approximate time of this telephone conversation with Mr. Davis?

A. I can't remember the exact month, but it was either in November or possibly December, 1952.

Q. Now, Mr. Taylor, referring back first to the directors' meeting of Pacific Rubber Company on January 5, 1951, that you have testified was the last meeting you attended, do you recall whether or not there was any discussion with respect to the possible transfer or sale of the Minnesota contract by Pacific Rubber Company?

A. No discussion whatever, wasn't even mentioned in the meeting that I attended.

Q. Now, with respect to the stockholders' meeting which you testified that you attended on that same date, was there any mention made— [220]

A. No mention whatever.

(Testimony of Glen A. Taylor.)

Q. Of this Minnesota contract?

A. No mention made of the synthetic rubber contract whatever.

Q. In your discussions with either the officers and directors of Pacific Rubber Company, or any employees, was any discussion or any conversation had with respect to a possible sale or transfer of the Minnesota contract by Pacific Rubber Company?

\* \* \* \* \*

Q. Mr. Taylor, during the course of either the directors' meeting or the stockholders' meeting held on January the 5th, 1951, in Oakland, at the offices of Pacific Rubber Company, by any chance was the name Bay Rubber Company, a partnership, ever mentioned?

A. No, it was not mentioned at all. [221]

Q. When did you first hear the name Bay Rubber Company?

A. The first I ever heard of Bay Rubber Company was after I had heard about the sale of synthetic rubber contract, so it must have been the very last of 1952 or possibly early 1953.

Q. Before that time, you knew nothing about the Bay Rubber Company or the facts surrounding this formation?

A. I had never heard of it.

Q. May I ask, do you recall when you left Oakland, California, after this stockholders' and directors' meetings on January 5, 1951, the approximate time?

(Testimony of Glen A. Taylor.)

A. Yes, I left the same day by commercial airline back to the factory on the evening of January 5.

Q. And do you know when the other individuals that were present at the stockholders' and directors' meetings when, whether they left the same day?

A. I have no knowledge when they left. I went to the airport and left immediately.

Q. Mr. Taylor, as vice president of Robbins Tire & Rubber Company, Incorporated, is it possible for you to state whether or not Robbins has ever received any money from the Bay Rubber Company?

A. I can state definitely that Robbins has not received any money from Bay Rubber Company.

Q. If the Robbins Tire & Rubber Company, Incorporated [222] had received any money from Bay Rubber Company, would you most likely know about it as vice president?

A. I would, I would probably know about it.

\* \* \* \* \*

Q. (By Mr. Herndon): Mr. Taylor, one more question. Since you left Oakland, California, on January 5, 1951, have you been back in the State of California?

A. I had not been back at all until last week when I came back for this trial, and after I had arrived was informed that it would not start until a few days later, and I had to return to the plant. I just arrived late last night, in fact about 2:30 or 3:00 o'clock this morning. I was delayed by the

(Testimony of Glen A. Taylor.)

storm. That is the second time I have been back since January 5, 1951.

Q. That is last week—

A. And this week.

Q. And this time today when you came this morning.

A. That's right, last week and last night.

Q. Very well.

Mr. Herndon: I have no further questions, your Honor. [223]

#### Cross Examination

Q. (By Mr. Dinkelpiel): Mr. Taylor, as I understand your testimony, you hold an executive position with Robbins Tire & Rubber Company?

A. That's correct.

Q. That position is vice president?

A. That's correct.

Q. And is it a position that has responsibility attached to it? A. Yes.

Q. Do you take orders and give orders, orders for purchases and you give orders for purchases?

A. Why no, I don't do anything about purchasing, although I do oversee purchasing, yes, I will say that.

Q. Do you manage any of the operations?

A. Yes, I do.

Q. Having anything to do with the finances?

A. I have nothing to do with the finances.

Q. Nothing at all to do with finances?

A. No.

(Testimony of Glen A. Taylor.)

Q. By managing the operation, what do you mean?

A. I mean that I have the over-all responsibility for the sale of all our products and the office administration; that is, over sales promotion, sales, the handling of complaints on flooring, handling complaints of all our products, to see that the office routine is carried out, to [224] see that the mail is answered, the telephone is answered.

Q. And that's a management operation, in other words; is it a manufacturing operation?

A. No, I have nothing to do with the manufacturing. I have responsibility for the sales management and administration.

Q. For the sales management and administration. I see. To repeat, just so I am straight on it, you have nothing to do with the financing?

A. No, I do not.

Q. Are the finances of Robbins Company handled out of the Mayflower Hotel, which is in Akron, Ohio?

A. The finances are supervised by Mr. Poncet Davis.

Q. By supervised, couldn't we use a stronger word, aren't they handled by Mr. Davis?

A. Yes, you could; you could say that.

Q. You have nothing to say about that?

A. No, I do not.

Q. Has anybody else anything to say about it?

A. Mr. Davis has the over-all say-so about finances.

(Testimony of Glen A. Taylor.)

Q. And you have answered me that nobody else has anything to say about it?

A. Under Mr. Davis. I will say no one overrules Mr. Davis but that there are others in the handling of finances under his direction.

Q. What do you mean by—carrying out his instructions? [225]      A. Yes.

Q. Now, Robbins Tire & Rubber had a substantial interest in, did it not, the Pacific Rubber Company? [225a]      A. That's right.

Q. Or was that Mr. Davis who had the interest?

A. No, it was Robbins Tire and Rubber Company.

Q. Robbins Tire and Rubber Company had a substantial interest of approximately 41 percent in Pacific Rubber Company?      A. That's right.

Mr. Archer: That's a defendant in this case.

Mr. Dinkelspiel: That's a defendant in this case and that's a corporation which Robbins had a substantial interest in.

Q. (By Mr. Dinkelspiel): Were you appointed by Robbins to represent it in the affairs of the Pacific Rubber Company?

A. I was appointed by Mr. Davis to represent Robbins.

Q. What form did that appointment take?

A. Why, it took the form of an appointment in a meeting in December 1948, when all three directors were appointed.

Q. That was a meeting where?

A. A meeting here in California.

(Testimony of Glen A. Taylor.)

Q. Were you here then?

A. No, I was not.

Q. You were told, how were you told you were a director of Pacific Rubber Company?

A. I don't recall exactly how I was told.

Q. When did you first learn about it? [226]

A. Well, shortly afterwards, and I don't recall the specific form or instrument in which I was told. I may have been told by Mr. Davis.

Q. You know how much money Pacific Rubber Company if any, put up—withdraw that question.

Do you know how much money Robbins Tire and Rubber Company put into Pacific Rubber Company? A. I do not.

Q. Do you know how much management it gave Pacific Rubber Company? [227]

\* \* \* \* \*

Q. (By Mr. Dinkelspiel): Did Robbins participate in the management of Pacific Rubber Company? A. Not to my knowledge.

Q. You wouldn't know, would you? Really, I am not trying to insult you, you are in a different branch of the business, you wouldn't know, would you?

A. I don't know about the extent of the management, no.

Q. I understood you attended no directors' meetings of the Pacific Rubber Company except one, and that was on January 5, 1951, is that correct?

A. That's correct.

(Testimony of Glen A. Taylor.)

Q. Did I understand you to say you didn't receive notice of meetings?

A. I said that I did receive notices of meetings, of all meetings.

Q. You signed many waivers of notice, isn't that correct? A. That's correct.

Q. And didn't attend the meeting?

A. That's right.

Q. Now, for example, there was produced by Robbins' counsel a document called Exhibit 7, Plaintiff's Exhibit 7. [228] The first, 7-A, is a letter addressed to you by Mr. Condrey, is that right?

A. That's right.

Q. When did you meet Mr. Condrey?

A. I met Mr. Condrey for the first time when I was here on January 5, attending the meeting.

Q. Attending the meeting. January 5, 1951.

A. 1951, that's right.

Q. That was the first time, wasn't it?

A. That's right.

Q. Now, 7-B purports to bear a signature of Glen A. Taylor; is that yours?

A. Yes, that's my signature.

Q. That's the waiver and consent to the holding of a special meeting of the Board of Directors of Pacific Rubber Company? A. That's right.

Q. What did you do with that, that document?

A. I believe I filed it.

Q. At whose instructions? A. Mr. Davis'.

Q. You didn't know what this was about, did you? A. Yes, I knew what it was about.

(Testimony of Glen A. Taylor.)

Q. Mr. Davis told you to file it?

A. That's right; that is the best of my recollection. [229]

Q. And not to go further in the matter, was that it?

A. Well, sometimes they sent me a copy, I may have mailed a copy, I don't remember.

Q. You don't remember?

A. No, but that is my signature.

Q. But to the best of your recollection it did not go back to the Pacific Rubber Company?

A. That's right.

Q. 7-H, the letter addressed to you by Pacific Tire and Rubber by John B. Condrey dated January 26, is that correct?

A. No, the letter is not addressed to me.

Q. That's right, it is addressed to Robbins Tire and Rubber Company, attention Mr. Poncet Davis, President. A. That's right.

Q. Did you ever see that letter before?

A. I don't recall seeing that letter.

Q. Did you ever sign any documents on behalf of Robbins Tire and Rubber Company in connection with a management of Pacific Tire and Rubber—Pacific Rubber Company?

A. Will you please clarify what you mean by "management"?

Q. I will withdraw the question and give you the opportunity to look at some of these documents.

I show you a document, Exhibit 13, Plaintiff, between Mr. Pauley and the Inland Rubber Com-

(Testimony of Glen A. Taylor.)

pany, John Condrey, Robbins Tire and Rubber Company, and call your attention [230] to the signature page and ask you if your signature appears anywhere, either individually or on behalf of anybody?

Mr. Archer: Doesn't the document show, counsel?

Mr. Dinkelspiel: I suppose it does, but it's preliminary, your Honor. I will rephrase the question.

Q. There's a signature of Robbins Tire and Rubber Company on that page is there not?

A. Yes.

Q. By whom is that?

A. Poncelet Davis, President.

\* \* \* \* \*

Q. (By Mr. Dinkelspiel): At any time did you sign any [231] contract in behalf of Robbins Tire and Rubber Company in relationship to the dealings or transactions involving Pacific Rubber Company?

A. I can't answer that. I wouldn't want to rely on my memory that far back.

Q. Well, would you say you signed any?

A. No, I will not say I signed any or I did not sign any.

Q. Do you recall any that you signed?

A. For Robbins, on behalf of Robbins?

Q. Yes. A. With Pacific?

Q. Yes. A. Rubber Company?

Q. That's right.

A. Well, I would say a waiver of notice of a meeting was a document.

(Testimony of Glen A. Taylor.)

Q. Apart from the waiver of notice of meeting?

A. That's right.

Q. Any others? A. Not that I recall.

Q. Did you ever send any letter signed by the Robbins Tire and Rubber Company by your signature? A. Oh, yes indeed, a great many.

Q. To Pacific Tire?

A. Pacific Rubber. [232]

Q. Pacific Rubber Company. A. Oh, yes.

Q. You did? A. Yes sir.

Q. Relating to what subject matter?

A. Oh, relating to the manufacture of inner tubes, sale of inner tubes.

Q. Anything with regard to any financial matters, such as the organization of Pacific Rubber Company or what transacted at its Directors' meetings or anything of that kind?

A. No, none that I recall.

Q. None that you recall. Now, I understand you to say that you first heard of the Bay Rubber Company sometime, you said, in 1952, late '52 or early '53?

A. That's to the best of my recollection. I was not much interested in Bay Rubber Company for the reason that Robbins was not interested in Bay, so I could be mistaken on the date. [233]

\* \* \* \* \*

Q. (By Mr. Dinkelspiel): Now, Mr. Taylor, to get back to what you did for Pacific Rubber Company, you attended one meeting, did you not, of the Board of Directors?

(Testimony of Glen A. Taylor.)

A. I have so testified.

Q. You attended none other?

A. Right.

Q. You signed several waivers of meetings?

A. That's correct.

Q. That's correct, without going into each and every one? A. Yes.

Q. Now, the meeting you attended was on January 5, 1951, was it not? A. That's right.

Q. That was a stockholder's meeting first, was it not?

A. It seems to me it was a directors' meeting first, although it may have been the other way around.

Q. Do you recall, or do you wish to refer to the minutes, whether any agreement was reached at first the stockholders' meeting as to the winding up and dissolution of Pacific Rubber Company?

A. Well, it's in the minutes; I don't know why I have to rely on my memory.

Q. A very good answer. Have you any independent recollection?

A. Certainly I do.

Q. What is your independent recollection as to what [234] transpired at the stockholders' meeting?

A. I can recall that the purpose of the meeting was the dissolution of the Pacific Rubber Company and that it was done at that meeting, but how and why I can't recall all that.

Q. Do you recall whether any discussion was had at that meeting with respect to offers to pur-

(Testimony of Glen A. Taylor.)

chase assets of Pacific Rubber Company by Mansfield Tire and Rubber Company or one of its subsidiaries?

Mr. Archer: What has that got to do with it?

Mr. Herndon: Objection again, your Honor, immaterial and irrelevant.

Mr. Dinkelspiel: It's preliminary, your Honor.

The Court: This is at the meeting?

Mr. Dinkelspiel: At this meeting.

The Court: He may answer.

A. (By the Witness): I don't recall that.

Q. (By Mr. Dinkelspiel): Do you recall whether Mr. Davis said at that meeting that he was not prepared to make a bid for the assets of Pacific Rubber Company?

A. No, I don't recall that. It seems to me Mr. Pauley did most of the talking at that meeting.

Q. You don't recall Mr. Davis having said anything of that character that I mentioned?

A. No, I do not. [235]

Q. Do you recall the directors' meeting?

A. Yes, I recall it.

Q. Now, the directors, did they not, determined to carry out the stockholders' instructions of winding up and dissolving the company; that you recall?

A. That's my recollection.

Q. And that meant, did it not, and it was so understood by you, that the substantial part, at least, of the assets of Pacific Rubber Company were to be delivered or sold and either the assets or the

(Testimony of Glen A. Taylor.)

proceeds delivered to Robbins Tire and Rubber Company and Condrey?

\* \* \* \* \*

Q. Mr. Taylor, Robbins Tire and Rubber Company, was, we have already found out, one of the two stockholders of Pacific Rubber Company, is that correct?     A. That's correct.

Q. And the other stockholder was Mr. Condrey?

A. That's right.

Q. And it is a fact, is it not, that upon the dissolution of the Pacific Rubber Company there was to be distributed to its stockholders certain assets and/or money? [236]

A. That's my understanding.

Q. Did you ever receive any such money yourself?     A. Robbins received some money.

Q. Yes.

A. From Pacific. I did not myself receive any, no.

Q. What part or any part did you have in the collection of those assets or money?

A. I had no part in it except that I happened to know as a matter of personal knowledge that Robbins Corporation did receive some money from Pacific.

Q. Isn't it a fact that Mr. Bouchard and Mr. Davis, were by action of the Robbins Tire and Rubber Company, appointed the representative of Robbins Tire and Rubber Company to handle the moneys and assets received?

A. That's correct, I believe.

(Testimony of Glen A. Taylor.)

Q. And you had no part of that?

A. No. [237]

\* \* \* \* \*

Q. Were you a director of Robbins Tire & Rubber Co. A. Yes, I was and am.

Q. Were you present at that meeting when Mr. Davis and— A. Yes.

Q. —Mr. Bouchard were authorized to act for the company? A. Yes. [240]

\* \* \* \* \*

Q. Actually you are not familiar with any of the financial side of Robbins Tire & Rubber Co. transactions?

A. No, I have testified that in the beginning I had nothing to do with the financial end of the company.

Q. You naturally have nothing to do with Mr. Poncet Davis's financial matters?

A. None whatever.

Q. Do you sign any checks for Robbins Tire & Rubber Co.?

A. On occasion when the controller is out of town, I am authorized to sign in an emergency.

Q. Did you sign any checks on Robbins Tire & Rubber Co. in favor of Mr. Davis?

A. I don't recall.

Mr. Dinkelspiel: That is all. [241]

#### Redirect Examination

Q. (By Mr. Herndon): Mr. Taylor, were you ever told at any time with respect to the Board of

(Testimony of Glen A. Taylor.)

Directors meetings of the Pacific Rubber Company that a Board of Directors meeting could be held without giving notice to the other directors?

A. No.

\* \* \* \* \*

Q. (By Mr. Herndon): Now, Mr. Taylor, in answer to one of Mr. Dinkelspiel's questions I believe you stated that [242] at the directors meeting Mr. Pauley did all the talking, is that correct?

A. That is my impression of the meeting, that he pretty much ran it, he did most of the talking.

Q. Well, as a director, didn't you deal with John Condrey?

A. Well, he was sitting there but he never said anything. Mr. Pauley did most of the talking.

Q. At the directors meeting Mr. Pauley did all the talking? A. That's right.

Q. How about the stockholders meeting?

A. The same thing. [343]

\* \* \* \* \*

(Whereupon the deposition of Mr. DeSellem was received in evidence and marked Plaintiff's Exhibit No. 28.) [250]

### PLAINTIFF'S EXHIBIT No. 28

[Title of District Court and Cause.]

#### DEPOSITION OF WESLEY H. DESELLEM

WESLEY H. DESELLEM

one of the defendants, being first duly cautioned and sworn by the notary public to tell the truth,

(Deposition of Wesley H. DeSellem.)  
the whole truth, and nothing but the truth, testified  
as follows:

Examination by Mr. Bouchard

Q. (By Mr. Bouchard): Will you, for the record, please state your full name, home address and occupation?

A. Wesley H. DeSellem; the address is — the business address is all right?

Q. Yes.

A. 100 Bush Street, San Francisco; occupation, CPA.

Q. Certified public accountant? A. Yes.

Q. And are you associated with any firm?

A. Associated with Lybrand, Ross Bros. & Montgomery.

Q. And since what date have you been associated with them? A. December 15th, 1952.

Q. Prior to that time, what was you occupation or business?

A. I was vice-president and treasurer of the Pacific Tire & Rubber Company.

Q. Of Oakland, California?

A. Oakland, California.

Q. And that was a company that was organized on or about [4] January 15th, 1951?

A. That is correct.

Q. Prior to that time, who were you connected with?

A. I was vice-president, treasurer and director of Pacific Rubber Company.

(Deposition of Wesley H. DeSellem.)

Q. And that was a company, as I recall, that was organized about December 28th, 1948, in which the two stockholders were John B. Condrey and Robbins Tire and Rubber Company?

A. That is correct.

Q. Prior to your connection with that company, what was your occupation?

A. I was secretary-treasurer, I believe was the title, and director of Oakland Rubber Company.

Q. The Oakland Rubber Company was the predecessor of Pacific Rubber Company, was it not?

A. That is right.

Q. And how long had you been vice-president and secretary and treasurer of the Oakland Rubber Company?      A. I was just secretary.

Q. You were just secretary?      A. Yes.

Q. Pardon me.

A. Approximately four years. Prior to that time, I was controller of the company.

Q. In other words, you went to work for Oakland Rubber Company—the company that became known as Oakland Rubber Company, in what year?

A. May, 1945.

Q. When did you become secretary, do you recall? [5]

A. Approximately a year later.

Q. Now, the Oakland Rubber Company had been known for years as Pacific Rubber Company, had it not?      A. That is correct.

Q. And in the latter part of the year 1948, it

(Deposition of Wesley H. DeSellem.)

changed its name from Pacific Rubber Company to Oakland Rubber Company?

A. That is correct.

Q. And what was the reason, if you know, for changing its name?

A. As far as I know, the successor company wanted to succeed to the name Pacific for reasons of brand names and advertising and good will.

Q. In other words, when Oakland consolidated, they sold just the assets to the new company; and the new company wanted the name Pacific, is that right? A. That is correct.

Q. And so the only change in the old Pacific Rubber Company was just in the name change?

A. Yes.

Q. Calling it Oakland for that purpose, is that correct?

A. Well, the Oakland—so there was quite a change in the Oakland Rubber Company. It sold its assets to the new company, the Pacific Rubber Company.

Q. Well, the change in name—the purpose of the sale to the new company was, I think you testified, to succeed in using the name?

A. Yes, that is right.

Q. Mr. Hedges has the minute book of the Oakland Rubber Company on the way, which, I suppose, would give us a definite [6] answer to this question, Mr. DeSellem.

Well, maybe you can tell us as to who the prin-

(Deposition of Wesley H. DeSellem.)  
cipal stockholders of the Oakland Rubber Company  
were?

A. The principal stockholders were Edwin W. Pauley and some of his family associates, Poncet Davis; as I recall, altogether they owned about, oh, maybe 86%.

Q. Yes, my recollection is that—see if this is yours—that Mr. Pauley owned about 51 or 52%, Mr. Davis owned 35%; and the balance of 13 or 14% was owned by a lot of small stockholders, is that true?     A. That is correct.

Q. Now, you are familiar with the fact that from the latter part of 1948 to December 28th, 1948, the Oakland Rubber Company sold its assets to Pacific Rubber Company, the newly formed corporation, are you not?

A. That is correct.

Q. There is in the minute book of Pacific Rubber Company, which Mr. Hedges has just handed me, what purports to be a copy of the sale agreement between Oakland Rubber Company and Pacific Rubber Company, dated December 29th, 1948.

It is signed by Oakland Rubber Company, by E. W. Booz, vice-president, and yourself as secretary, of Oakland. Do you recall that?

A. I recall the agreement.

Q. Do you recall that you executed the contract—that is, you and Mr. Booz executed the contract on behalf of Oakland? [7]     A. Yes.

Q. Now, at the time that Oakland made the sale to Pacific Rubber Company, you knew, did you

(Deposition of Wesley H. DeSellem.)  
not, that Oakland would sustain a loss upon that  
sale? A. I did.

\* \* \* \* \*

Q. (By Mr. Bouchard): In connection with the  
sale, Oakland did sustain a loss, did it not?

A. Oakland did sustain a loss.

Q. Do you recall now the amount of that loss,  
roughly?

A. Oh, my recollection is \$600,000.00, roughly.

\* \* \* \* \*

Q. When did you resign, if you did resign, as  
secretary or as an employee of Oakland Rubber  
Company?

A. I don't remember the date.

Q. You became an officer of Pacific Rubber  
Company immediately upon its formation, did you  
not? A. That is correct.

Q. And you were one of the original directors  
of Pacific Rubber Company, weren't you, in the  
articles of incorporation?

A. I am not sure that I was mentioned in the  
articles of incorporation.

Q. I call your attention, Mr. DeSellem, to a  
copy of the original articles of incorporation of  
Pacific Rubber Company, [14] and to the signature  
of V. Hendrickson and Orris R. Hedges.

A. Yes.

Q. As being named in the original articles as  
directors. Do you recall that, now?

A. I don't recall the form of those documents.

Q. At the time that you became an officer or an

(Deposition of Wesley H. DeSellem.)  
employee or a director of Pacific Rubber Company,  
did you resign any position you had with the Oakland  
Rubber Company?

A. I am not sure when I resigned from the Oakland Rubber Company.

Q. You remained as a director of Pacific Rubber Company from the time of its organization, well, I guess, to the present time, isn't that so, or did you resign as a director? Do you know whether you have or not?

Mr. Hedges: Pacific Rubber Company?

Mr. Bouchard: Yes.

A. I don't recall whether I resigned as a director of Pacific Rubber Company. I think the company was dissolved. In any event, I was director up until the time of dissolution, as far as I know.

Q. It filed a certificate of intention to dissolve about the 10th of January, 1951. You did continue as a director after that date, did you not?

A. I did.

Q. Now, when the Pacific Rubber Company took over the assets of Oakland, Oakland had operated at 4901 East 12th Street, in Oakland, had it not? A. Yes. [15]

Q. And Pacific Rubber Company continued to operate at the same address?

A. That is correct.

Q. Using the same facilities?

A. That is correct.

Q. And substantially the same employees, is that true? A. That is true.

\* \* \* \* \*

(Deposition of Wesley H. DeSellem.)

Q. Now, when the company operated the Oakland Rubber Company, Mr. DeSellem, from whom did you take your instructions in connection with the performance of your duties?

A. I think they came from several sources; from both representatives of—. You are talking about Oakland now?

Q. Yes.

A. Both representatives of Mr. Pauley and Mr. Poncet Davis.

Q. You got some instructions, I assume, from [16] both Mr. Davis and Mr. Pauley, is that true?

A. The company had only a minor number of business transactions, I recall; and there were hardly any instructions involved.

Q. It was operated for several years as Pacific Rubber Company, was it not?

A. You are talking about Oakland Rubber Company prior to the time of the sale?

Q. That is right; that is right.

A. The early part of the time I was with Oakland—or Pacific Rubber Company, which became Oakland Rubber Company, Mr. Davis was president of the company.

Q. And you took some instructions from him, I assume?

A. I took a considerable number of instructions from him.

Q. Did you take any instructions from either Mr. Pauley or Mr. Cameron?

A. I probably was advised by them; but if there

(Deposition of Wesley H. DeSellem.)

was a case of any conflict between their suggestions and any standing orders of Mr. Davis, they were referred to Mr. Davis. He was president of the company.

Q. And his determination, I assume, was the one that you followed? A. Not always.

Q. Sometimes, then, you took the view that Mr. Pauley and Mr. Cameron had, is that correct?

A. Sometimes I took a neutral attitude, and did what I thought was best.

Q. You mean there were occasions then when you overruled [17] the principal stockholders, and you did what you thought was best, and were not governed by their views?

A. I don't think I overruled them—in effect overruled them. I did what I thought was for their best interests.

Q. Who was the production manager of Oakland Rubber Company and its predecessor?

A. Mr. Booz.

Q. That is Earl W. Booz? A. Correct.

Q. Now, Mr. Booz continued along as the production manager for Pacific Rubber Company, did he not? A. That is correct.

Q. And continued in that capacity during the entire time that Pacific Rubber Company operated the property at 4901 East 12th Street, didn't he?

A. That is correct.

Q. And even continued along for a time in such capacity with the new company, as I recall—

A. That is correct.

(Deposition of Wesley H. DeSellem.)

Q. (Continuing): —the Pacific Tire and Rubber Company. Now, who was the president, if you recall, of Pacific Rubber Company?

A. You are talking about Pacific Rubber Company now?

Q. Yes.

A. As of January, 1949? There was no president.

Q. Mr. Booz was the executive vice-president?

A. He was the executive vice-president.

Q. Now, during your employment by Pacific Rubber Company after it acquired Oakland's assets, from whom did you take instructions with respect to the performance of your duties?

A. The two principal stockholders were Mr. Condrey and [18] Mr.—well, Robbins Tire and Rubber Company, represented by Mr. Davis, Poncet Davis.

Q. What position did Mr. Condrey have with Pacific Rubber Company?

A. He was director and secretary.

Q. During the period of your employment at Pacific Rubber Company, did you ever take any instructions from either Mr. Pauley or Mr. Cameron with respect to the performance of your duties?

A. I wouldn't say that I took instructions from them. I listened to their advice.

Q. They gave you advice, did they, with respect to your side of the operations?

A. They did. \* \* \* \* \* [19]

(Deposition of Wesley H. DeSellem.)

Q. (By Mr. Bouchard): Mr. DeSellem, are you as a director and secretary of Pacific Rubber—were you familiar with the stock [31] ownership of Pacific Rubber Company?

A. This is Pacific Rubber Company? That wasn't Oakland Rubber Company?

Q. No, this is Pacific Rubber Company that succeeded to Oakland.

Mr. Hedges: Do you mean—

A. I wasn't secretary of Pacific Rubber Company that succeeded to Oakland Rubber Company.

Q. (By Mr. Bouchard): That is right; you were vice-president and secretary?

A. Vice-president and treasurer.

Q. And director?      A. And director.

Q. And you are familiar with the fact that there were only two stockholders of that company—or John B. Condrey and Robbins Tire and Rubber Company?      A. That is correct.

Q. Are you familiar with their stock ownership or percentages?      A. I was.

Q. Do you recall that the percentage of the stock held by Mr. Condrey was 58.59701%; and that Robbins was 41.40299%? Do you recall that?

A. Those are the approximate percentages, as I recall it.

Q. Do you know how those percentages were arrived at?

A. I had nothing to do with the computation of them.

Q. You did not compute them?      A. I did not.

(Deposition of Wesley H. DeSellem.)

Q. Do you know how they were arrived at? If you know? A. Not definitely, no. [32]

Q. Do you have any idea?

A. Why, I think they had a relation to prior ownership.

Q. You mean prior ownership between Mr. Pauley and Mr. Davis in Oakland? Is that what you mean? A. Yes. [33]

\* \* \* \* \*

Q. (By Mr. Bouchard): Mr. DeSellem, do you recall that during the month of June, the latter part of June, 1951, Pacific Tire & Rubber Company disbursed something like \$60,000.00 under the heading of management fees; \$30,250.00 to E. W. Pauley and associates, and the balance to Mr. Hoffman of Mansfield? Do you recall that?

A. I recall the management fees paid. They were paid—either paid or accrued in June of 1951.

Q. And paid by whom?

A. I think the amounts were approximately \$30,000.00 to the so-called Pauley group; and approximately \$15,000.00 to the management of either the Inland Rubber Corporation or Mansfield Tire & Rubber Company.

Q. Well, do you recall specifically that the check for the Pauley group—there was a check to E. W. Pauley and associates of \$30,250.00.

A. I don't recall exactly how the check was made out; but I know there was a check in about that amount.

Q. And was a similar amount given to either

(Deposition of Wesley H. DeSellem.)

Mr. Hoffman or the Mansfield Company or Inland?

A. It wasn't similar, no.

Q. What amount was given to them? [36]

A. I don't remember the exact amount.

Q. Didn't they on the books of Pacific Tire & Rubber Company get an equivalent amount?

A. They didn't get an equivalent amount in cash.

Q. How did they get it?

Q. (By Mr. Hedges): Did they get an equivalent amount? Do you know that in any way?

A. They got an equivalent—part of it in cash and part by credit against the merchandise they were purchasing from Pacific Tire & Rubber Company.

Q. (By Mr. Bouchard): So Pauley and associates got the \$30,250.00 in cash, and Hoffman or Mansfield got part in cash and part in an inventory or merchandise credit, is that correct?

A. That is correct.

Q. Yes. Now, do you recall, Mr. DeSellem, that at the time that money was disbursed to Mr. Pauley and for Pauley and associates, whether or not it was disbursed by Pacific Tire pursuant to any statement from E. W. Pauley and associates for services?

A. I don't recall.

Q. You had a check voucher, didn't you, when you issued checks of that sort?

A. The company did, yes.

Q. Do you remember, Mr. DeSellem, giving a deposition in the case of Robbins Tire and Rubber

(Deposition of Wesley H. DeSellem.)  
Company, Plaintiff, versus Pacific Tire & Rubber Company, a case pending in the District Court of the United States, Northern District of California, [37] No. 32028, on the 9th day of May, 1953, in these same offices—that is, the offices of this firm—in which Mr. Hart took your deposition?

A. I recall the deposition.

Q. Do you recall on that occasion being examined by Mr. Clark, and the following questions asked you and the following answers given by you:

“Q. I hand you, Mr. DeSellem, a group of checks which have been marked ‘Plaintiff’s Exhibits 19a through to 19h for identification’; and call your attention to certain items:

“I call your attention to 19e, which appears to be a voucher, is that right?

“A. That is a check copy voucher.

“Q. A check copy voucher? A. Yes, sir.

“Q. And it states on there, ‘6/29, Fees per statement, \$30,250.00.’ What does this particular statement refer to?

“A. That refers to a statement submitted to the company by E. W. Pauley Associates.

“Q. Who directed the making of this voucher?

“A. I did.

“Q. You had before you at the time the statement— A. I did.

“Q. (Continuing): —that is referred to here?

“A. Yes.

“Q. Where is that statement now, do you know?

“A. I think it is attached to another—we used

(Deposition of Wesley H. DeSellem.)

another [38] check copy besides this. We have one that is filed numerically and another one filed alphabetically. That statement is attached to the alphabetical copy of the check copy.

"Q. This was then in payment of E. W. Pauley and Associates, is that right?

"A. That is correct, a statement to the Pacific Tire & Rubber Company.

"Q. To the Pacific Tire and Rubber Company for services of some kind? A. That is correct."

Q. Do you recall those questions, and that you made those answers? A. I do.

Q. And they are a correct statement in answer to the questions?

A. I believe them to be correct.

Mr. Diehm: What page is that?

Mr. Bouchard: I am reading—I started, Mr. Diesm, from page 61, and part of page 62.

Q. Now, on what authority, Mr. DeSellem, did you issue this check to E. W. Pauley and Associates for \$30,250.00?

A. I talked to the representatives of both owners of the company about it.

Q. Do you mean Mr. Pauley and Mr. Hoffman representing Inland or—

A. I talked to Mr. Cameron, who was representing Mr. Pauley; and I talked to Mr. Hoffman, who was representing Inland Rubber Corporation.

Q. And they advised you or told you to issue those checks [39] for services, is that correct?

A. They did.

(Deposition of Wesley H. DeSellem.)

Mr. Bouchard: I will return this to you, Mr. Hedges. I am returning the balance sheet.

Q. Now, do you know of any other payments that were made either to Mr. Pauley and Associates or Mr. Pauley individually, or to Mr. Hoffman, or to Mansfield, or to Inland, of a similar kind other than the one we just talked about while you were treasurer of the company?

Mr. Hedges: What do you mean by a similar kind, Mr. Bouchard?

Mr. Bouchard: For management services.

A. I am not sure if there were any further payments made or not.

Q. Had there been made any prior to June of 1951?

A. No, there were none made prior to that time.

Q. Whether there were some made subsequently, you don't recall? A. I don't recall.

Q. Now, Mr. DeSellem, I want to call your attention to what purports to be the minutes of a regular meeting of the board of directors of Pacific Rubber Company held on the 21st day of May, 1951, at the offices of Pacific Tire & Rubber Company, at which you and Mr. Condrey were present as directors, and Mr. Taylor was absent; and ask you if you will examine the minutes, if you will, please, and then tell whether that is your signature as chairman of that meeting?

(Document handed to witness.) [40]

A. That is my signature.

\* \* \* \* \*

(Deposition of Wesley H. DeSellem.)

Q. (By Mr. Bouchard): Mr. DeSellem, you were chairman of that meeting, and announced that the meeting was held for the purpose of adopting a resolution authorizing the officers of the corporation to enter into a contract or contracts with Bay Rubber Company, a co-partnership, for the sale, assignment and transfer of all of this corporation's interests in and to that certain agreement dated August 28th, 1950, between Minnesota Mining & Manufacturing Company, Pacific Rubber Company, and Reconstruction Finance Corporation; and of two other agreements, one dated September 20th, 1950, between Minnesota Mining & Manufacturing Company and Pacific Rubber Company, one commonly known as the "M-P Agreement," and the other as the "Patent Agreement," for the consideration of \$5,000.00.

Whose idea was it to sell these contracts to the Bay Rubber Company?

A. I was informed by the parties involved [41] in the sale of the assets of Pacific Rubber Company to Pacific Tire & Rubber Company, that this particular agreement was not to be involved in that sale; that Bay Rubber Company was being specifically formed to take over the performance of that agreement at the time Pacific Rubber Company went into dissolution.

Q. What person did you discuss it with?

A. I discussed it with Mr. Condrey, Mr. Hedges, Mr. Cameron, Mr. Pauley and Mr. Davis, and Mr. Taylor.

(Deposition of Wesley H. DeSellem.)

Q. When did you have this agreement—. Were they all together at this discussion?

A. They were all at the company's offices; and I don't think they were all together. The discussion was held at different intervals; and I don't think I was present at the time they were all together.

Q. When was it held?

A. The early part of January, 1951.

Q. And you say you discussed this with Mr. Davis and Mr. Taylor? A. I did.

Q. And they told you, did they, that the Bay Rubber Company was being formed for the sole purpose of taking over the operation of—let us call it the synthetic plant, is that correct?

A. I don't know that that was their words. It was mentioned that Bay Rubber Company was going to take over the performance of this contract. [42]

Mr. Hedges: I think you misquoted him, Mr. Bouchard, when you said that was the sole purpose. I don't think he said that in his first answer.

Q. (By Mr. Bouchard): Well, tell us what either Mr. Davis or Mr. Taylor told you?

A. I don't remember their exact words; but I knew they were familiar with the—from my conversations with them, with the fact that Bay Rubber Company was going to take over their performance of this contract; and that Mr. Davis would have an ownership in Bay Rubber Company.

Q. All right. Now, fix as nearly as you can for

(Deposition of Wesley H. DeSellem.)  
me the date when you talked to Mr. Taylor or  
to Mr. Davis?

A. The date of the directors' meeting, January,  
1951, as I recall.

Q. Well, now—

A. Possibly there was another meeting in De-  
cember, too; but I am not sure.

Mr. Hedges: You are referring, Mr. DeSellem,  
to the date of this special stockholders' meeting, or  
directors' meeting, at the plant? A. Yes.

Q. (By Mr. Bouchard): Now, there was an  
agreement—

A. I had talked to Mr. Davis at different times;  
but I believe it was on the same day. He was also  
at the plant in December, 1950, I think.

Q. That is all right. There was a meeting of  
the board of directors of Pacific Rubber Company  
on January 15, 1951, [43] as shown by the minutes.  
Was that the occasion, do you think, when you  
talked to him? A. Can I look at those?

Q. Sure. [44]

\* \* \* \* \*

The Witness: The meeting was January 5th.

Q. (By Mr. Bouchard): Wasn't that the meet-  
ing of January 15th? A. No.

Q. It was at a prior meeting?

A. I think it was the 5th of January.

Q. The 5th of January.

Mr. Hedges: A special stockholders' meeting.  
Wasn't it sent to everybody?

A. Yes, it is shown here. [45]

(Deposition of Wesley H. DeSellem.)

Q. (By Mr. Bouchard): If I recall your testimony correctly, Mr. DeSellem, and in view of your answer, you talked to Mr. Davis, or Mr. Taylor, or both of them, on or about January 5th, 1951?

A. That is correct.

Q. And they were at the plant on that occasion, were they? A. Yes, sir.

Q. Now, I think you testified also that at the plant at the same time were Mr. Cameron and Mr. Pauley and Mr. Hedges and Mr. Condrey; and you also talked to them on the same occasion, is that true?

Mr. Hedges: He didn't mention Mr. Pauley, I don't believe.

A. I mentioned Mr. Pauley.

Mr. Hedges: Oh, did you?

Mr. Bouchard: Yes, he did.

A. I am not sure he was present at the plant at that time. I talked to him about it; but I am not sure it was on that day.

Q. You talked to Mr. Pauley, you talked to Mr. Cameron, and you talked to Mr. Condrey, did you?

A. Yes.

Q. At or about that date?

A. At or about that date.

Q. (By Mr. Bouchard): Earlier, or possibly at the same time. And did Mr. Pauley tell you that the Bay Rubber Company was going to take over this synthetic contract from Pacific?

A. He did.

Q. Did Mr. Cameron tell you that?

(Deposition of Wesley H. DeSellem.)

A. He did.

Q. And I think you have answered this question: You also said that Mr. Davis and Mr. Taylor told you that? [46]

A. I am not sure about Mr. Taylor; but I know I talked to Mr. Davis about it.

Q. All right. Now, I want to refer, Mr. DeSellem, again to the deposition which you gave in the offices of this law firm on the 9th of May, 1953, in the case of Robbins Tire and Rubber Company, Incorporated, Plaintiff, versus Pacific Tire & Rubber Company, action No. 32028, in the District Court of the United States, for the Northern District of California. You remember that occasion, do you?

A. Yes.

Q. And I will ask you whether on that occasion you remember being asked these questions and making these answers—

Mr. Diehm: Page?

Mr. Bouchard: 79.

“Q. You stated sometime ago in your examination here that the Pacific Rubber Company intended to sell the Minnesota Mining contract to the Bay Rubber Company. You mean Bay Rubber Company, the partnership? “A. That's right.

“Q. How do you know that?

“A. There was a discussion at the time of the dissolution of the corporation.

“Q. By whom? A. It was discussed by—

“Q. And you participated in the discussion, did you?

“A. It was discussed in front of me. I can't

(Deposition of Wesley H. DeSellem.)

say that I participated in it very much; but it was necessary to—for [47] the company to divest itself of this contract in order to dissolve. Also it was necessary to obtain the consent of the Minnesota Mining Company to dissolve the Pacific Rubber Company; and that was the time that the matter was discussed; and that I was present; and that it was decided to sell the contract to the Bay Rubber Company.

“Q. Who else was present?

“A. As I recall, Mr. Cameron was present; and I believe Mr. Hedges was present; and I think at one time, Mr. Pauley was present.

“Q. That was all?

“A. That was all I remember. And Mr. Condrey.

“Q. And Mr. Condrey?

“A. I think Mr. Condrey.

“Q. No one else, as far as you recall?

“A. No, not as far as I know.”

Do you remember those questions, and giving those answers?

A. Not specifically, but probably so.

Q. If those questions were asked and you made those answers at that time, they were true and correct, were they not? A. I presume so.

Q. Who at the directors' meeting of May 21st, 1951, suggested that the price for selling this synthetic contract to Bay be \$5,000.00? How did you arrive—you and Mr. Condrey, as the sole directors present at the meeting, figured \$5,000.00 as the purchase price? [48]

A. My recollection of it was that in January of

(Deposition of Wesley H. DeSellem.)

1951 the price was to be a nominal amount, plus Bay Rubber Company assuming the obligations of the contract.

Q. All right. Now, are you familiar with those contracts with Minnesota Mining Company?

A. I am not familiar with all of the details of them.

Q. Well, are you familiar with the obligations that the Bay Rubber Company had under those contracts?

A. They had—. I am familiar with one of the obligations they had, yes.

Q. What was that?

A. An obligation—a commitment for \$350,000.00.

Q. Based on what?

A. That commitment was to put up that amount of working capital to offset any loss from operations that might be incurred at the outset of the program.

Q. Well, by that, do you mean—. What do you mean by the outset? You took it over in the fall, or September, 1950?

A. I believe they started to operate their plant in December, 1950; and in the meanwhile, they had all of the problems of getting the plant ready for operation.

Q. Then do you mean that under these agreements with Minnesota Mining and RFC, that Pacific Rubber Company had a contingent liability up to \$350,000.00 for working capital if it were re-

(Deposition of Wesley H. DeSellem.)  
quired in connection with the operation of the plant?

A. That is my memory of the agreement, yes.

Q. Now, up until May 21st, 1951, had Pacific Rubber Company ever been called upon to put up anything by way of working capital?

A. We had already put up some funds to pay for the project engineer and his principal expenses.

Q. And who was that? A. Ray Kerr.

Q. In other words, the only expense that Pacific Rubber had in connection with the synthetic plant operation was in connection with perhaps Ray Kerr's salary and expenses, is that right?

A. In the summer and fall of 1950, the Pacific Rubber Company expended approximately \$50,000.00 on the project.

Q. In the summer of 1950?

A. In the summer and fall.

Q. In the summer and fall? A. Yes.

Q. The agreements with Minnesota Mining were not in effect with Pacific until August and September, is that correct?

A. I believe those to be the dates.

Q. Had Pacific Rubber Company put up this \$50,000.00 that you were talking about during the summer of 1950 prior to the execution of the formal contract?

A. Well, the money was expended by them prior and afterwards.

Q. And Pacific put that up—taken out of its own funds, was it? A. Yes, it did.

(Deposition of Wesley H. DeSellem.)

Q. And did it ever put up any other money? Was it ever called upon to put up any other money after that fifty thousand? [50]

A. Only, as far as I remember, to pay for the project engineer, Ray Kerr—his expenses, perhaps. I think there were several things that were incurred in connection with the negotiations for the contract.

Q. Paid to whom?

A. I don't remember the name.

Q. Well, to the attorneys, or were they engineers, or—

A. I think they were. I think one was to an attorney, as I recall. I don't remember the name.

Q. Do you recall who the attorney was that represented Pacific Rubber in your negotiations with Minnesota as to the contracts?

A. A large firm in Los Angeles. I think O'Melveny was part of the—O'Melveny & Myers. I believe that is the firm. That is my recollection.

Q. Now, on May 21st, 1951, when you and Mr. Condrey, as directors, sold this synthetic contract to the Bay Rubber Company for \$5,000.00, were you aware of the amount of income from January 15th, 1951, to May 21st, 1951, that Pacific would have been entitled to under that contract with Minnesota?

A. I don't think they were entitled to any income.

Q. Why not?

A. The company was in dissolution.

(Deposition of Wesley H. DeSellem.)

Q. Is it your idea that a copy in dissolution does not get the benefit under a contract to which it is a party?

A. I don't think so. Not that contract.

Q. If they owned a contract and not assigned it, the Bay [51] Rubber wouldn't have gotten that contract?

A. They couldn't have gotten the contract.

Q. Why not?

A. Because they had gone into dissolution; and that was—doesn't that stop them from performing under the contract?

Q. Is that your idea of the responsibility of a director in the corporation that when it dissolves, it is not entitled to any and all benefits it is entitled to under a contract?

A. It is my idea under the contract.

Q. Is that your idea of contracts generally, or are you just talking about this one specifically?

Mr. Hedges: He is talking about this one, Mr. Bouchard.

Mr. Bouchard: Let us get it from him; not from you.

Mr. Hedges: He is not a lawyer.

A. I think—. I am not an attorney, remember that; but I think if a company has a contract, and if by the provisions in it that it fails to—as in this case they went into dissolution, that it automatically becomes disqualified from enjoying any benefits of the contract.

Q. (By Mr. Bouchard): Under the contract

(Deposition of Wesley H. DeSellem.)

with Minnesota, isn't it true that Minnesota was the operating party to that contract, with the charge of the operation of the plant, wasn't it—the synthetic plant?

A. I think Minnesota and Pacific had a joint obligation under the contract.

Q. You think Pacific had some duties to perform in connection [52] with its operation of the contract? A. They did, yes.

Q. Pardon me? A. They did.

Q. Do you know what those duties were? Do you recall?

A. I couldn't specify them here. I would have to read the contract.

Q. You have read the contract, I take it, in times past?

A. I think I read the contract once about four and a half years ago.

Q. Well, was the \$5,000.00 purchase price, in the light of your testimony—was it fixed by you and Mr. Condrey, or were you told by Mr. Pauley and Mr. Cameron of Bay Rubber Company that this was what they would pay for it?

A. We were told by Mr. Cameron that that was what—. I was told by Mr. Cameron—I am not sure Mr. Condrey was there—that that would be the amount that the Bay Rubber was going to pay for the contract, plus assuming the obligation of performance.

Q. Now, that meeting of May 21st, Mr. DeSellem, Plaintiff's Exhibit 4, recites that you and Mr.

(Deposition of Wesley H. DeSellem.)

Condrey were the only ones present; Mr. Taylor, the third director, was absent.

Do you know whether or not any notice of this meeting was given to Mr. Taylor? A. I do not.

Q. All you know, he wasn't present?

A. I know that.

Q. I notice that the minutes, these same minutes which you signed as chairman of the meeting, recite that this was [53] the regular meeting of the board of directors of Pacific Rubber Company.

Was that a regular meeting or a special meeting?

A. I wouldn't know—recall whether it was or not. If they were held on a regular meeting day, it was probably a regular meeting; but I am not sure it was held on a regular meeting day.

Q. Do you know what the regular meeting day was? A. I don't recall at this time.

Q. As a matter of fact, it wasn't a regular meeting day.

Mr. Hedges: For what?

A. I think there were regular meetings established in the by-laws of the board of directors.

Q. (By Mr. Bouchard): All right. I will show you the by-laws of Pacific Rubber Company in the back of the minute book handed to me by your counsel; and ask you to find the place in there that fixes the regular meeting of the board of directors.

A. "Regular meetings of the board of directors shall be held at any place within or without the State which has been designated from time to time by resolution of the board or by written consent of

(Deposition of Wesley H. DeSellem.)

all members of the board. In the absence of such designation regular meetings shall be held at the principal office of the corporation. Special meetings of the board may be held either at a place so designated or at the principal office."

Q. Now, will you tell the reporter, please, Mr. DeSellem, [54] what that is?

A. This is page 9 of the by-laws, section 5.

Q. Section 5. Will you look at the by-laws, and tell me if you can find any other reference in them to the time of holding meetings?

A. There is a section with respect to special meetings.

Q. Well, I am not interested in those; unless you are, but I am not.

Will you see if there is any other place in the by-laws referring to the holding of special meetings.

A. I think that would take a considerable length of time. I have referred to one specifically; and there may be another one in there hid somewhere that I wouldn't know about.

Q. Well, take your time. There are separate headings that you will observe as to what the by-laws cover. Probably you will be able to find it. Take as much time as you think necessary.

A. Here is a reference to it under duties of the secretary.

Q. What is that?

A. "The secretary shall give, or cause to be given, notice of all the meetings of the shareholders

(Deposition of Wesley H. DeSellem.)  
and of the board of directors required by the by-laws or by-law to be given."

Q. That is section what, Mr. DeSellem, or article?

A. Section 9, page 14. Here is a section with respect to adjourned meetings, under Section 12, page 11:

"A quorum of the directors may adjourn any directors' [55] meeting to meet again at a stated day and hour; provided, however, that in the absence of a quorum, a majority of the directors present at any directors' meeting, either regular or special, may adjourn from time to time until the time fixed for the next regular meeting of the board."

I guess it is not a quorum—a majority of the board.

Q. Yes. Mr. DeSellem, you have made a rather hasty examination of the by-laws; but the one section of the articles to which you referred was the only one in this examination that you found that has any reference to meetings of the board of directors, is that not true?

A. And this last section.

Q. Now, in none of those articles of the—provisions of the by-laws, does it fix a particular day of any month for holding regular meetings, does it?

A. Apparently not.

Q. When did you last examine this minute book, Mr. DeSellem? When did you last see it?

A. This morning.

(Deposition of Wesley H. DeSellem.)

Q. Here when your deposition was being taken?

A. Yes.

Q. How recently had you examined it before that time? A. Yesterday afternoon.

Q. In preparation for the taking of your deposition, is that right? A. I presume so.

Q. And did you go over it pretty carefully yesterday? [56]

A. No, I did not. I did not go over it carefully at all; but I was just refreshing my memory as to dates and as to when things happened.

Q. In going over the minutes yesterday, were you satisfied the minutes as reflected in the minute book correctly reflect what was done at each of the directors' meetings held?

A. I have no exception to the information I looked at.

Q. They appeared to you to correctly reflect what occurred at the meetings, is that right?

A. Yes.

Q. Now, I think that the minutes show—you have them before you, and you can check this and to see if it is not correct—that the minutes show that you were present at all of the directors' meetings except one, which was a special meeting on May 18th, 1951. Did the board of directors of Pacific Rubber Company meet regularly every month? A. No, they did not.

Q. If I have correctly counted the number of directors' meetings as reflected by your book, Mr. DeSellem, they show that including the first meet-

(Deposition of Wesley H. DeSellem.)

ing of the board of directors on December 28th, 1948, and ending with the meeting, directors' meeting, May 21st, 1951, which was the last directors' meeting reflected in the book, some fourteen directors' meetings were held; and of those thirteen—or eleven, were special meetings; and there were only three regular meetings held: There were two regular meetings on January 15th, 1951, one at 10:00 o'clock in the morning, and one at 10:30; and the other one, [57] the last one, namely, May 21st, 1951. Will you look at those minutes and see if that is a correct statement?

A. Going back here to the by-laws—

Q. I just want to clear that up.

A. You asked me about regular meetings and special meetings?

Q. You can tell by looking at the beginning, you can tell what they are.

A. Start in 1949 or 1948?

Q. December 29th, 1948, is the first meeting of the board of directors?

A. That would be a regular meeting. That was called the first meeting.

Q. Yes, that is right.

A. Then there was a special meeting on the same day.

Q. All right. It might be a little easier for you, Mr. DeSellem, working backwards in the book—that may help you—just tell me from the minute book how many regular meetings are designated

(Deposition of Wesley H. DeSellem.)

by the book that were held by the board of directors, and the dates of them.

A. We have the first one, December 29th, 1948. January 15, 1951, appears to be the next one.

Q. All right.

A. There seem to be two meetings that day; two meetings on January 15th, 1951. A meeting on the 21st of May, which was designated as a regular meeting.

Q. Well, then, my statement appears to be correct, that [58] there were only three regular meetings of the board of directors held by the company from the time of its organization until and including the meeting of May 21st, 1951, is that correct?

A. Well, you can't—. January 15th, are you counting that as one, but actually there were two meetings.

Q. There were actually two meetings?

A. Yes. [59] \* \* \* \* \*

Q. (By Mr. Bouchard): I notice one of the clauses in this assignment, Mr. DeSellem, says: [60] "Whereas, on January 15, 1951, Assignor agreed—" that is Pacific Rubber Company—"agreed to transfer all of its right, title and interest in and to said Agreement of August 28, 1950, to Bay Rubber Company when it could secure the consent of Minnesota Mining and Manufacturing Company to its agreements with it dated September 20, 1950; said transfer to be effective as of January 15, 1951, regardless of date of execution of formal assignment."

(Deposition of Wesley H. DeSellem.)

Was that agreement on the part of Pacific Rubber Company made on January 15th, 1951, in writing or not, do you know?

A. As far as I know, it was not.

Q. It was not. When Pacific Rubber Company made its agreement with Minnesota Mining in September of 1950, and assumed the obligations you have talked about—the continued obligation which you say could run up to \$350,000.00, did not Minnesota require some security of that promise on the part of Pacific?

A. I don't recall whether it did or not.

Q. Do you recall whether or not Minnesota Mining Company required Oakland Rubber Company to subordinate its claim against Pacific on its note to any claim Minnesota might have against Pacific?

A. I don't recall.

Mr. Bouchard: I would like to see the minutes again, please.

Q. I call your attention, Mr. DeSellem, to the minutes of the special meeting of the Board of Directors of Pacific Rubber [61] Company, held at the plant on September 20th, 1950, and ask you if that is your signature as chairman of the meeting and Mr. Condrey's as secretary?

A. That is my signature.

Q. What is that? A. Yes.

Q. And you recognize Mr. Condrey's signature as secretary? A. Yes.

Q. Will you look at those minutes and see if they refresh your recollection as to whether or not

(Deposition of Wesley H. DeSellem.)

Minnesota required Oakland to subordinate its interest, its claim, against Pacific to that of Minnesota's in connection with the operation of this plant?

A. It recites in the minutes that the Minnesota Mining and Manufacturing Company required that Pacific Rubber Company enter into an agreement whereby Oakland Rubber Company agrees with Minnesota Mining and Manufacturing Company and Pacific Rubber Company to subordinate its claims against Pacific Rubber Company to Pacific Rubber Company's obligations to Minnesota Mining and Manufacturing Company.

Q. Yes. Now, having read that, Mr. DeSellem, does that refresh your recollection that Minnesota did require that? A. It did require it.

Q. Yes. And do you now recall—. May I see the book again, please?

Do you now recall that at that meeting, you and Mr. Condrey as directors adopted a resolution authorizing Harry [62] Wright, vice-president, and John Condrey, secretary, to enter into an agreement of subordination with Minnesota Mining and Manufacturing and Oakland? A. I do.

Q. And was such a subordination agreement entered into? A. That I don't remember.

\* \* \* \* \*

Q. Now, Mr. DeSellem, I want to direct your attention to the minutes of the first meeting of the board of directors of Pacific Rubber Company, which was held on the 29th of December, 1948; and the minutes recite that there were present Orris R.

(Deposition of Wesley H. DeSellem.)

Hedges, Wesley H. DeSellem and V. Hendrickson, being all of the directors of the corporation named in its articles of incorporation; and they purport to have been signed by all three of them. No, I will take that back—by Mr. Hedges, [63] as chairman, and V. Hendrickson, as secretary.

Will you look at those minutes, look them over and tell me if you have any recollection as to whether or not they correctly report what was transacted at that first meeting.

(Document handed to witness.)

Mr. Hedges: You have already asked him that question once with respect to all of the minutes, and he said that they did.

Mr. Bouchard: Those are the minutes of the—the first meeting.

Mr. Hedges: Your question was as to all of the minutes; and your question was whether he had gone over the minute book, and whether they reflected in his opinion what transpired, and he said yes.

Mr. Bouchard: I think you are right, Mr. Hedges.

Q. And that answer goes for the minutes of the first meeting that I showed you, Mr. DeSellem?

A. I think so.

Q. All right. I had forgotten I had asked you that other question.

Now, I wish you would turn to the minutes of the directors' meeting on January 15th, 1951, at the first meeting that was held at 9:00 o'clock in the

(Deposition of Wesley H. DeSellem.)

morning, or 10:00 o'clock in the morning. Do you have them in front of you? A. I have.

Q. The minutes of the meeting of the directors of January 15th, at 10:00 o'clock in the morning, were signed by you and [64] Mr. Condrey as chairman and secretary, respectively?

A. That is correct.

Q. Now, all that was done at that meeting was to authorize the deposit of funds in the account of Pacific Rubber Company into the so-called Cameron Trustee account, is that not true?

A. That is correct.

Q. Now, the minutes show also that you and Mr. DeSellem—you and Mr. Condrey were the only directors, and Mr. Taylor was absent, is that correct? A. That is correct.

Q. Now, if you will turn to the minutes of the meeting of the same date, January 15th, held at 10:30—do you have those in front of you?

A. I have them in front of me.

Q. That likewise shows that you and Mr. Condrey were the only ones present; and that Mr. Taylor was absent, is that right?

A. That is correct.

Q. And the only business that was transacted by the directors at that meeting was to vote Mr. Pauley a 10% fee for services he had rendered in connection with the synthetic contract, is that not true?

A. That is true.

Q. Why were there two meetings held instead of having transacted that business in one meeting?

(Deposition of Wesley H. DeSellem.)

A. My recollection is that there were two meetings, that we had to have minutes of the resolution to go to the American Trust Company. [65]

Q. Which resolution had to go?

A. The first meeting.

Q. The one at 10:00 o'clock? A. Yes.

Q. And you mean you had to have that typed up and delivered before you could hold the second meeting?

A. Not necessarily before we held the second meeting. The two meetings were held so that we could have a separate meeting for the purpose of giving the American Trust Company a copy of the minutes of the meeting.

Q. Couldn't you have held that meeting—voted Mr. Pauley his fees at the first regular meeting at 10:00 o'clock, and giving the American Trust Company only the resolution in which that is recited?

Mr. Hedges: That is objected to as argumentative.

A. I suppose it could have been done; but this is the way we did it. [66]

\* \* \* \* \*

Q. (By Mr. Bouchard): What services had Mr. Pauley rendered Pacific Rubber Company which in your opinion justified voting him this 10%

A. He was responsible for the—he was primarily responsible for the company obtaining the contract.

Q. You mean the contract with Minnesota Mining? A. That is correct.

(Deposition of Wesley H. DeSellem.)

Q. And you as a director felt that those services were worth this 10% of the management fees received from that source? A. I did.

Q. Whose suggestion was it that Mr. Pauley be voted this fee?

A. As I recall, Mr. Condrey had worked it out with Mr. Cameron.

Q. Mr. Condrey had worked out the deal with Mr. Cameron? A. Yes.

Q. Mr. Cameron representing Mr. Pauley?

A. That's right.

Q. Do you know whether or not, Mr. DeSellem, at these meetings at which—these directors' meetings at which this was voted—whether or not either Mr. Pauley or Mr. Cameron was present at the meeting?

A. I don't believe they were. I couldn't be sure of it, but I don't believe they were.

Q. Let us go to the meeting of May 21st, 1951, when this synthetic contract was told to Bay: Were either Mr. Cameron [67] or Mr. Pauley present at the meeting? A. They were not.

Q. This meeting held January 15th, 1951, in which the 10% fee was voted to Mr. Pauley, that was after Pacific Rubber had filed with the secretary of state of the State of California its election to dissolve, wasn't it?

A. That's right. I think that it was the same day it elected to dissolve, on January 15th. The notice was filed prior to that time; but I believe that was the date selected to dissolve.

Q. January 15th? A. Yes.

(Deposition of Wesley H. DeSellem.)

Q. And did Pacific Rubber Company actually dissolve on January 15th?

A. They disposed of all of its assets, with the exception of obtaining consent of the Minnesota Mining and Manufacturing Company for the transfer of the synthetic plant to the Bay Rubber Company.

Q. On January 15th, it sold all of its assets to Pacific Tire and Rubber Company except the synthetic rubber plant.

A. They were supposed to do it. They declared it as a liquidating dividend to the stockholders.

Q. All right. Let us get that straight. I think you are right, Mr. DeSellem, but let us get it straight for the record. A. Yes.

Q. Pacific Rubber Company voted to liquidate—the stockholders and directors both voted to liquidate? A. That is correct. [68]

Q. And as a result of that vote to liquidate, it distributed all of its assets to the stockholders, Robbins and Condrey, isn't that true?

A. That is correct.

Q. And part of those assets, the plant and physical equipment, or all of the assets of Pacific except the synthetic plant, were sold to Pacific Tire & Rubber Company on January 15th?

A. All except the accounts receivable and cash. They were turned over to the trustee to collect and liquidate.

Q. They were distributed?

A. To the stockholders.

Q. To the stockholders. And the stockholders

(Deposition of Wesley H. DeSellem.)

appointed Mr. Cameron as trustee or as agent to collect those? A. That is correct.

Q. That is true. The only assets remaining which had not been distributed to the stockholders was this synthetic contract? A. That is right.

Q. And that was transferred on May 21st to the Bay Rubber Company. That is the history of it, isn't it? A. That is correct.

Q. All right. Now, I notice, Mr. DeSellem—and for your information, it is true—I notice there was a special meeting of the board of directors of Pacific Rubber Company on the 18th of May, 1951; and a waiver of notice and consent to holding of special meeting of board of directors of Pacific Rubber Company which was signed by Mr. Booz and Mr. Condrey.

Mr. Booz was never a director of Pacific Rubber Company, [69] was he?

A. Not to my knowledge.

\* \* \* \* \*

Q. (By Mr. Bouchard): Just another question or two, Mr. DeSellem.

It is my recollection in all of these meetings of the directors' meetings you acted as chairman of the meetings, and [70] Mr. Condrey acted as secretary; and at nearly all of the special meetings, a waiver was sent out to all of the directors, and signed by them, including Mr. Taylor. The regular meetings—there were two of them—so denominated—of January 15th, 1951, and on May 21st, 1951, there appears to be no waiver and no notice given to Mr. Taylor.

(Deposition of Wesley H. DeSellem.)

Do you know why it was that Mr. Taylor was not notified of those two meetings of January 15th, 1951, and the one of May 21st, 1951?

A. I do not. \* \* \* \* \*

Q. Mr. DeSellem, I want to direct your attention again to the minutes of the first meeting of the board of directors held December 29th, 1948, which recite that you, Mr. Hedges, and V. Hendrickson, being all of the directors of the corporation, were present; and I want to call your attention to page 5, in which the following appears:

"The chairman stated that Article 3, Section 5 of the By-Laws of this corporation provided for the adopting of a resolution designating the time and place of holding regular [71] meetings of the Board of Directors, and upon motion duly made, seconded and unanimously carried, the following resolution was adopted:

"'Resolved, that regular meetings of the Board of Directors of this corporation shall be held, without call, on the third Monday of each month at the hour of 10:00 o'clock a.m. at the principal office of the corporation located at 4901 East 12th Street, Oakland, California; provided, however, should said day fall upon a legal holiday, then said meeting shall be held at the same time on the next day thereafter pursuing which is not a legal holiday. Notice of all such regular meetings of the Board of Directors is hereby dispensed with.'"

Do you recall now, using the minutes of that meeting to refresh your recollection, whether that resolution was adopted at that first meeting?

(Deposition of Wesley H. DeSellem.)

A. That was adopted.

Q. It was adopted?      A. Yes.

Q. And may I see them again, please? And do you recall at that same meeting, the minutes of that first meeting, that the chairman stated that it would be necessary for the corporation to execute a loan agreement with the American Trust Company with respect to the obligations of Oakland Rubber Company in the sum of \$166,666.80 and \$350,000.00, which obligation this corporation is assuming; and that a motion was made and a resolution adopted as follows in that meeting, and that [72] covered that last resolution there. Was that resolution adopted at the first meeting?      A. It was.

Q. It was?      A. Yes.

\* \* \* \* \*

Q. Mr. DeSellem, I want to ask you one question or two questions about Pacific Tire & Rubber Company.

My recollection is this company showed a pretty good profit for several months after its organization, January 15th, 1951, up to along through September or October of 1951. That is true, isn't it?

A. That is correct.

Q. And from that time on, for several months thereafter, every month it showed very substantial losses, is that true?

A. That is true. [73]

\* \* \* \* \*

Examination by Mr. Hedges

Mr. Hedges: I have one or two questions.

(Deposition of Wesley H. DeSellem.)

Q. Mr. DeSellem, I believe you stated that Glenn A. Taylor represented the Robbins Tire and Rubber Company on the board of directors of Pacific Rubber Company, is that correct?

A. That is correct.

Q. Did Mr. Taylor at any time take any active part in the operation of Pacific Rubber Company?

A. He had no active part whatsoever.

Q. Did he ever attend any meetings of the board of directors of Pacific Rubber Company?

A. Only one.

Q. And when was that, if you recall?

A. I believe the date was January 5th, 1951.

Q. That was a special meeting—that is the date of the special meeting of the stockholders that was held?      A. Yes.

Q. At which time it was decided to dissolve the company?      A. That is correct.

Q. I believe on questioning by Mr. Bouchard, you made a statement that all of the assets of Pacific Rubber Company [76] upon dissolution were transferred to the stockholders. Is that a correct statement?

A. Well, that is incorrect in one case. The contract with the Minnesota Mining and Manufacturing Company was not transferred on January 15th, 1951.

Q. Was it transferred at any other time, or distributed out at any other time to the stockholders?

A. The proceeds from it were distributed to the stockholders later.

(Deposition of Wesley H. DeSellem.)

Q. Yes, but not the contract itself?

A. Not the contract itself.

Q. Never at any time?

A. No. I don't suppose it could have been done.

Mr. Hedges: Very well. That is all, Mr. DeSellem. I don't have any further questions.

\* \* \* \* \*

Reexamination by Mr. Bouchard

Q. Now, you say that Mr. Taylor was not particularly active in the affairs of the company; and I think from what I noticed, [78] that is a fair statement.

Who were the people who were active in the affairs of Pacific Rubber Company?

A. The officers who directed the management of the company.

Q. Well, that would be Mr. Booz, the executive vice-president?      A. Yes.

Q. Yourself, as vice-president-treasurer, and Mr. Condrey as secretary?

A. Mr. Condrey as secretary; and Harry Wright at that time was vice-president in charge of sales.

Q. Who else was active in the operation of the company?

A. As far as the actual management of the company is concerned, we ran the company, the four of us.

Q. Was Mr. Pauley active in the management of the company?      A. No.

Q. Did he have anything to do with the management? Did he spend any time in its affairs?

(Deposition of Wesley H. DeSellem.)

Q. I would say he gave advice as to policies.

Q. And his advice was pretty generally followed, wasn't it? A. Not always.

Q. Was Mr. Cameron active in the affairs of the company? A. In a similar way to Mr. Pauley.

Q. In advising on its operation, is that what you mean? A. That is correct.

Q. Is it a fact, is it not, that Mr. Cameron made very frequent trips from Los Angeles to Oakland in connection with the affairs of Pacific Rubber Company, though, did he not? [79]

A. He only did at certain intervals of time. We went long periods of time when practically the officers of the company practically operated the company by themselves. There would be intervals when he would be present.

Q. Didn't you have very frequent long distance telephone calls to Mr. Cameron and Mr. Pauley with respect to the affairs of Pacific Rubber Company?

A. Oh, I don't think they were what you would call frequent. Maybe a couple of times a month, or something like that. Mr. Pauley was a very heavy creditor of the company, and very interested—quite interested in the affairs of the company.

Q. Didn't Mr. Pauley as a matter of fact take a very substantial beneficial interest in Pacific Rubber Company?

A. His only interest at that time was a note of Oakland Rubber Company of which he owned some 51 or 52%.

(Deposition of Wesley H. DeSellem.)

Q. Isn't it a fact, Mr. DeSellem, that it is common knowledge of all of the people connected with the Oakland Rubber Company and Pacific Rubber Company that Mr. Condrey was holding his interest for Mr. Pauley's benefit?

Mr. Hedges: That is objected to as calling for a conclusion of this witness.

Mr. Bouchard: That is no conclusion. If he knows.

Q. Isn't that your understanding?

A. That is not my understanding.

Q. Is it your understand that Mr. Condrey was holding that interest for himself, and that he was the owner—and [80] that he was the sole owner of his stock interest in that company?

A. As far as I knew, he was the sole owner.

Q. And neither Mr. Pauley nor Mr. Cameron nor Mr. Condrey have ever done anything to you that would indicate otherwise? A. No, sir.

\* \* \* \* \*

#### Reexamination By Mr. Hedges

Q. (By Mr. Hedges): Mr. DeSellem, Mr. Bouchard has asked you, wasn't it a fact that Mr. Pauley and Mr. Cameron made frequent calls to your plant. Isn't it a fact that Mr. Davis called almost every day?

A. He called—I would say he called more frequently than either Mr. Pauley or Mr. Cameron.

Q. And that was concerning the operation of the plant?

A. Concerning the operation of the company.

Mr. Hedges: That is all.

(Deposition of Wesley H. DeSellem.)

Reexamination By Mr. Bouchard

Q. (By Mr. Bouchard): Mr. Davis did not get as much information about the operations as you gave Mr. Pauley and Mr. Cameron, however, did he?

A. I think that Mr. Davis did—he was sent a complete monthly statement every month of all the financial operations of the company.

Q. And that is all he got, was the monthly statement, [81] wasn't it?

A. Oh, no. He called on the phone, and asked a large volume of questions every month about our operations.

Q. And did you answer them? A. Yes.

Mr. Hedges: You are talking about the time, now, prior to the time the company went into dissolution?

Mr. Bouchard: Yes.

Q. What about after the company went into dissolution?

A. He called, and I answered any questions with respect to the Pacific Rubber Company. I did not answer his questions with respect to the Pacific Tire & Rubber Company. [82]

\* \* \* \* \*

Reexamination By Mr. Hedges

Q. (By Mr. Hedges): Just one more question: Mr. Davis, representing Robbins Tire & Rubber Company, had the habit of making collect calls when the Bay Rubber Company was in operation; and that was continued when the company became Pacific Tire and Rubber Company?

(Deposition of Wesley H. DeSellem.)

A. That is correct. That was one of the bones of contention, was the large telephone bill. Sometimes these calls ran as high as \$400.00 a month; and that was one of the bones of contention.

\* \* \* \* \*

[Endorsed]: Filed Dec. 16, 1955. [83]

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CLAUD L. CAMERON

previously sworn, resumed the stand and testified as follows:

\* \* \* \* \*

Direct Examination

The Court: State your name, please.

The Witness: Claud L. Cameron.

Q. (By Mr. Herndon): Mr. Cameron, what is your residence, please?

A. 232 South Hamilton Drive, Beverly Hills, California.

Q. What is your occupation?

A. I am in the employ of Edwin W. Pauley, independent [253] oil producer, and also a joint venturer in various enterprises.

The Court: Also what?

The Witness: A joint venturer in various enterprises.

Q. (By Mr. Herndon): In various enterprises with Mr. Pauley?      A. And others, yes.

Q. And others, yes. What is your address for business purposes?

A. 717 North Highland Avenue, Los Angeles, California.

(Testimony of Claud L. Cameron.)

Q. Do you share an office with Mr. Pauley, share general offices? A. Yes.

Q. And your office is next to Mr. Pauley's at 717 North Highland Avenue in Los Angeles?

A. Yes.

Q. Very well. Mr. Cameron, are you familiar with the partnership, a limited partnership, formed under California law, known as the Bay Rubber Company? A. Yes.

Q. Are you a member of that partnership by any chance? A. Yes.

Q. Were you at any time appointed a trustee or agent for one John B. Condrey and the Robbins Tire & Rubber Company in connection with any matter? A. Yes.

Q. Would you tell the Court, please, for whom and the [254] circumstances under which you were appointed agent or trustee? Just briefly.

The Court: Isn't there a document covering this?

Mr. Hedges: Yes, there is.

Mr. Herndon: Yes, there is, your Honor.

The Court: Why don't we get the document?

Mr. Hedges: I don't believe it was introduced.

Mr. Archer: Exhibit 14.

Mr. Clark: It's in evidence.

Q. (By Mr. Herndon): Mr. Cameron, I hand you what has been admitted in evidence as the plaintiff's Exhibit 14. Does that document, is that the evidence of your trusteeship in connection with the liquidation of Pacific Rubber Company for John B. Condrey and Robbins Tire & Rubber

(Testimony of Claud L. Cameron.)

Company, Incorporated?        A. It is.

Q. When were you appointed trustee or agent for the purposes of the liquidation of Pacific Rubber Company?

Mr. Dinkelspiel: Otherwise than stated in this document?

Mr. Herndon: No, as stated in the document.

A. January 15, 1951. [255]

\* \* \* \* \*

Q. Mr. Cameron, in connection with your trusteeship, did you at any time have funds or income come through your trustee accounts from a certain contract known as Minnesota contract for the operation of certain synthetic rubber plants?

A. Yes, I did, the income derived from that contract through January 14, 1951.

Q. What was the date, please, January 14, 1951?

A. Through January 14, 1951.

Q. Do you have any knowledge as to what happened to the income from the Minnesota contract after January 16, 1951?

A. Yes, I do, but the date was subsequent to January [256] 14, 1951.

Q. Oh, I'm sorry, I misunderstood you; January 14, 1951, then.

A. It was paid to Bay Rubber Company.

Q. Do you have any knowledge as to when the amount was paid to Bay Rubber Company, this income from the Minnesota contract?

A. The first payment was about September, 1951.

(Testimony of Claud L. Cameron.)

Q. September, 1951. Very well. What were the circumstances, Mr. Cameron, to your knowledge, leading to the receipt of this income from the Minnesota contract by Bay Rubber Company?

A. I will have to go back to a meeting in Oakland early in January, 1951, when the agreement was reached by the stockholders of Pacific Rubber Company to liquidate. The arrangements prior to the liquidation were that the plant and inventories received by Robbins and Condrey in liquidation would be sold to a new corporation to be formed and owned by a subsidiary of Mansfield Tire & Rubber Company and by a partnership to be formed, the principal partners to be Mr. Pauley and Mr. Davis.

\* \* \* \* \*

A. (Continuing): Among the assets to be specifically excluded from the sale to the new corporation was the synthetic rubber contract. There was a definite reason for that. Mansfield Tire & Rubber Company was a participant in another—

The Court: Another what?

A. (Continuing): —was a participant in another synthetic rubber contract. It was our understanding that the policy of the rubber reserve or RFC was not to look favorably upon or possibly not even allow one company to participate in more than one of the synthetic rubber contracts.

Discussion was had as to the assignment of the synthetic rubber contract to the contemplated partnership. There was considerable, let us say, head scratching about the accomplishment of such a

(Testimony of Claud L. Cameron.)

transfer because we thought it would involve the consent of rubber reserve or RFC and also the Minnesota Mining and Manufacturing Company, who were the operators of the plant. It was decided that every effort would be made to accomplish the transfer to the proposed partnership.

Q. (By Mr. Herndon): When you say every effort was made to accomplish the transfer to the proposed partnership, [258] between whom was that effort made, that is, Mr. Cameron, who are the individuals between whom discussions were held with respect to the transfer of the Minnesota contract?

A. I remember definitely a conversation with John Condrey and George Bouchard and Wesley DeSellem.

Q. Were there any other individuals that you recall at this time who were present during the course of those conversations?

A. I cannot definitely state to my knowledge that I discussed it with any others on that day, I believe January 5, 1951, in Oakland.

Q. And then you do fix the date as January 5, 1951, when those discussions were held with respect to a transfer of the synthetic contract, the Minnesota contract, to Bay Rubber Company?

A. That was my first discussion.

Q. Yes. Now, was this discussion held at a board of directors' meeting or stockholders' meeting, or was it merely an informal discussion? I am referring now to January 5, 1951.

(Testimony of Claud L. Cameron.)

A. It was — they were informal discussions, but on the same day that the stockholders' meeting and directors' meeting was held.

Q. Yes. But may I ask, Mr. Cameron, were you present at the directors' meeting of Pacific Rubber Company held in Oakland on January 5, 1951? [259]

A. I do not recall whether I was in the room at the time the directors' meeting was held or not; I was not a director.

Q. Then, of course, if you were not in the room you wouldn't recall any discussion at the directors' meeting with respect to the Minnesota contract, is that correct? It automatically follows.

A. I do not recollect any.

Q. Yes. Now, may I also ask you, Mr. Cameron, please, were you present at the stockholders' meeting of Pacific Rubber Company held in Oakland on January 5, 1951?

A. I do not recall whether I was in the room at the time the stockholders' meeting was held or not; I probably was.

Q. Then if you were not in the room you would, of course, know nothing about the conversations that took place in the room; that automatically follows also.

Mr. Cameron, may I also ask you, please, when did you first obtain knowledge that the Minnesota contract held either by Pacific Rubber Company or by you as trustee for John B. Condrey and

(Testimony of Claud L. Cameron.)

Robbins Tire and Rubber Company was assigned to the Bay Rubber Company?

A. It was never held by me as trustee.

Q. Very well. Subject to that correction, would you answer my question, please, if possible.

The Court: What is the question? Will you please [260] reframe it?

Q. (By Mr. Herndon): The question then is when did you first obtain knowledge that the Minnesota contract for the operation of the synthetic rubber plants in Torrance, California, and I am referring to the interest held by Pacific Rubber Company, was assigned to the Bay Rubber Company partnership, assigned or sold?

A. Oh, I imagine probably around June 1; I do not recall exactly.

Q. June 1 of which year, Mr. Cameron?

A. 1951.

Q. Around June 1 of 1951. How did you obtain that knowledge, please?

A. There was quite a prelude to that. A great deal of work was done with Rubber Reserve and RFC as to accomplishing the transfer from Pacific Rubber Company to Bay. I was in the office of James L. Hayes in Chicago some time around, oh, possibly April of 1951. Mr. Hayes and Mr. Pauley called John Conley of Minnesota Mining and Mr. Conley said that Minnesota Mining had come to the conclusion that they had a contract with Pauley and they were going to live up to it, and they said they

(Testimony of Claud L. Cameron.)

would hurry along the matter of making the assignment and try to accomplish it as soon as possible.

They informed us at that time also that they were [261] desirous of transferring the contract from Minnesota Mining to a subsidiary called Midland Rubber.

Q. Have you finished, Mr. Cameron?

A. Yes.

Q. Mr. Cameron, now I understand I believe the evidence indicates the transfer by Minnesota Mining and Manufacturing Company of their interest in the Minnesota contract, as we refer to it here, to the Midland Rubber Company. Now, however, I do not understand your answer with respect to what Minnesota had to do with the transfer of the interest of Pacific Rubber Company in that contract to Bay Rubber Company. Would you explain that again, please?

A. Rubber Reserve raised a question as to whether Pacific could transfer its interest to anyone. We gave serious consideration to cancelling Pacific's participation in the synthetic contract, cancelling it entirely.

Minnesota Mining, after a lot of legal study, came to the conclusion as far as they were concerned they were the recipient of a hundred per cent of the fees and they did not need the consent of Rubber Reserve to recognize Bay; and as Mr. Conley put it, Minnesota had a contract with Pauley and we are going to live up to it.

Q. Mr. Cameron, actually RFC or the Rubber

(Testimony of Claud L. Cameron.)

Reserve, as I understand it, is merely a wholly owned subsidiary of the Reconstruction Finance Corporation, never did consent [262] and to this day hasn't consented, has it, to the transfer of Pacific's interests, that is, the Pacific Rubber Company's interest, in that contract to Bay Rubber Company? A. That is correct.

Q. And in fact Mr. Pauley hired, I believe, a lawyer in New York, our former Secretary of War, Royall, to try and obtain the permission of RFC to the assignment of the contract from Pacific Rubber to Bay Rubber Company, is that not true?

A. That is correct, but he was hired by Bay and not Mr. Pauley.

Q. That permission, as you stated, has never been obtained? A. That's right.

Q. Very well, Mr. Cameron, are you familiar with the board of directors' meeting of the Pacific Rubber Company dated May 18, 1951, and also May 23, 1951—May 21, I am sorry—1951?

Mr. Hedges: Show him to which you refer, counsel.

Q. (By Mr. Herndon): Now, Mr. Cameron, I hand you what has been admitted in evidence as Plaintiff's Exhibit 15, which is the minute book en toto of the Pacific Rubber Company, and I refer you specifically to the minutes of the board of directors of Pacific Rubber Company for the 18th day of May, 1951, a copy of which has also been admitted in evidence individually as Plaintiff's Exhibit 19. [263]

(Testimony of Claud L. Cameron.)

May I ask whether you have previously seen those minutes?

A. I don't recollect that I have. [264]

\* \* \* \* \*

Q. Mr. Cameron, have you ever seen any documents with respect to the transfer of the Minnesota contract of Pacific Rubber Company to the Bay Rubber Company partnership?

A. I believe there is an assignment. I wonder if I could look at it, please.

(Counsel handing document to the witness.)

Q. (By Mr. Herndon): Mr. Cameron, I hand you what has been admitted in evidence as the Plaintiff's Exhibit 21, which is an assignment, a document showing an assignment from the Pacific Rubber Company to the Bay Rubber Company. I will ask you whether you have ever seen that document before?

A. Yes, I believe I have seen this document.

Q. Other than that document, which is the assignment just referred to, have you seen any other document with respect to the transfer of the Minnesota contract from Pacific Rubber Company to the Bay Rubber Company partnership?

A. I am quite sure that I saw and possibly signed a check—no, I don't believe I signed a check, but I knew of a check that was paid Pacific Rubber Company in consideration of this assignment. [265]

Q. What was the amount of that check?

A. \$5,000.

Q. By who—who was the payee on the check?

(Testimony of Claud L. Cameron.)

A. I believe Pacific Rubber Company.

Q. Who was the payor on the check, again if you know, of course?

A. Bay Rubber Company.

Q. Bay Rubber Company. Who ultimately, Mr. Cameron, received that \$5,000 check, or the proceeds of it?

A. John Condrey and Robbins Tire & Rubber Company.

Q. In other words, you received that \$5,000 check, or the proceeds of it, as trustee for Condrey and for Robbins Tire & Rubber Company, is that correct?

Mr. Dinkelspiel: Object to the question as calling for the opinion and conclusion of the witness.

The Court: He is asking if he received it.

Mr. Herndon: That's right, he received it.

Mr. Dinkelspiel: As trustee for someone. All right.

The Court: Did you receive it first, at all, did you get the check?

The Witness: The check would have been handled like any other payments to Pacific Rubber Company. They were endorsed and put in an account, entitled--in the bank account entitled "C. L. Cameron, Trustee for John Condrey and Robbins Tire & Rubber Company." [266]

The Court: The checks were all endorsed that way?

The Witness: Yes, sir.

(Testimony of Claud L. Cameron.)

The Court: Then state again how they were endorsed.

The Witness: It would have been handled the same as any other check made to Pacific Rubber Company. For instance, in collection of accounts receivable, the check would be made in the name of Pacific, to the Pacific Rubber Company. The check would then be deposited in a back account of the American Trust Company, and the name of the account was C. L. Cameron, Trustee, for John Condrey and Robbins Tire & Rubber Company, and from that account, from time to time, as trustee, I made disbursements to the two beneficiaries.

Q. Mr. Cameron, you are a general partner of Bay Rubber Company, is that correct? A. Yes.

Q. Would you tell the Court, please, when you became a general partner, the approximate date?

A. There is a document here that is an amendment to the original Bay Rubber Company agreement that has the exact date.

Q. Yes. May I suggest it was some time during December, 1951; would that be approximate?

Mr. Dinkelspiel: Show him the document.

Mr. Archer: Exhibit 3.

Q. (By Mr. Herndon): Mr. Cameron, I hand you what has been admitted in evidence as Plaintiff's Exhibit 3. By the inspection of that document can you tell us when you were admitted as a general partner to the Bay Rubber partnership?

A. The document is dated the 28th day of December, 1951.

(Testimony of Claud L. Cameron.)

Q. And prior to that date what was your status with the Bay Rubber Company, if any?

A. Limited partner.

Q. You were a limited partner from the inception or formation of the partnership, is that correct? A. Yes.

Q. Until that date shown on Plaintiff's Exhibit 3? A. Yes. [268]

\* \* \* \* \*

Q. Yes, indeed, Mr. Cameron. Mr. Cameron, I hand you what has been marked for identification as Plaintiff's Exhibit 18, and will you state whether you have presently seen that document or can identify it? A. (No response.)

Q. Mr. Cameron, may I describe the document in a little more detail, please?

Exhibit 18 is a letter written to Mr. Edwin W. Pauley on the letterhead of Pacific Rubber Company dated January 15, 1951, and signed on behalf of Pacific Rubber Company by John B. Condrey as secretary of that corporation.

Mr. Dinkelspiel: Could I see that, counsel, please?

Mr. Herndon: Yes, indeed, Mr. Dinkelspiel.

Mr. Dinkelspiel: That was, as you say, only offered for identification.

Mr. Herndon: In the lower left-hand corner the caption "Approved and accepted" bearing the signature, or what purports to be the signature, rather, of Edwin W. Pauley; then underneath that the caption "Approved Bay Rubber Company," and

(Testimony of Claud L. Cameron.)

bearing what purports to be the signature of Edwin W. Pauley on behalf of Bay Rubber Company.

Q. Now, Mr. Cameron, will you state, please, whether you have previously seen that document?

A. I cannot swear that I have seen this document, but I knew, however, the general terms of the agreement. [275]

\* \* \* \* \*

(Letter previously marked Plaintiff's Exhibit 18 for identification now received in evidence.)

PLAINTIFF'S EXHIBIT No. 18

Pacific Rubber Company  
Factory and General Offices  
4901 East Twelfth Street  
Oakland 1, California  
January 15, 1951

Mr. Edwin W. Pauley  
717 North Highland Avenue  
Los Angeles 38, California

Dear Sir:

Pursuant to a Resolution of the Board of Directors of this corporation, duly and regularly adopted at a regular meeting of the Board of Directors on January 15, 1951, this corporation agreed to pay to you a commission equal to 10% of the net fees received by this corporation under the so-called Minnesota-Pacific Operating Agreement dated September 20, 1950. This letter, when accepted by you, will act as an agreement between us whereby you will receive the amount above specified as con-

sideration for services which you have rendered to this corporation. We have this day assigned all of our interest under the aforesaid Operating Agreement to Bay Rubber Company and we will pay the commission due you up to this date and Bay Rubber Company will pay the commissions accruing thereafter directly to you.

If the foregoing meets with your approval kindly indicate your acceptance in the space provided in the lower left-hand corner hereof.

PACIFIC RUBBER COMPANY

/s/ By JOHN B. CONDREY  
Secretary

Approved and accepted:

/s/ EDWIN W. PAULEY

Approved:

BAY RUBBER COMPANY

/s/ By EDWIN W. PAULEY.

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Q. (By Mr. Herndon): All right, now, Mr. Cameron, to your knowledge was notice ever given to the Robbins Tire & Rubber Company, Incorporated, with respect to the assignment of the Pacific Rubber Company interest in the Minnesota contract? [278]

Mr. Hedges: By whom, Counsel?

Mr. Herndon: I said to his knowledge whether notice was ever given.

Mr. Hedges: By whom?

Q. (By Mr. Herndon): Did you give any notice, Mr. Cameron? A. No.

Q. At no time did you give notice?

(Testimony of Claud L. Cameron.)

Mr. Hedges: He has answered that.

Mr. Herndon: Very well.

Q. To your knowledge did any other individual give notice of the assignment of the contract to Bay Rubber Company? A. Yes.

Q. Who was that individual, please?

A. Mr. Edwin Pauley, I believe it was in April, 1951, telephoned to Mr. Poncet Davis advising him verbally that Minnesota Mining had agreed to honor the agreement that had been entered into and it was intended as fast as the mechanics with Minnesota could be accomplished to transfer to Bay Rubber Company.

I believe it was the next day.

The Court: Let's finish that first.

Read that up to then.

(Answer read by the Reporter.)

The Court: Transfer what, the Minnesota contract to Bay Rubber? [279] A. Yes, sir.

The Court: Go ahead, Mr. Cameron. You started to say "the next day."

A. The next day Mr. Davis called Mr. Pauley at the Ambassador East Hotel in Chicago and said he had checked with his tax men and they said it was O.K., to go ahead and make the transfer of the Minnesota contract to Bay.

Q. (By Mr. Herndon): Mr. Cameron, was this purported phone call of Mr. Pauley's on the date fixed by you, to your knowledge before or after the transfer of the Pacific Rubber Company interest in the Minnesota contract to Bay Rubber Company?

A. It was before.

(Testimony of Claud L. Cameron.)

Q. It was before the transfer?

A. Yes.

\* \* \* \* \*

### Cross Examination

Q. (By Mr. Dinkelspiel): For purpose of clarification, Mr. Cameron, will you describe to His Honor what took place on January 5, 1951, with respect to meetings? You have testified that you were not at either the stockholders' meeting or the directors' meeting, to the best of your recollection, but that you were at some kind of a meeting or gathering. Will you explain that, please, to the Court?

A. From time to time during the recess, various groups would get together separately in various offices of the Pacific Rubber Company in Oakland for the purpose of discussing various mechanical details. Sometimes it would be one little group, sometimes another little group, sometimes Mr. Pauley and Mr. Davis would go into a room and have a discussion.

Q. Now, it was at one of these meetings or discussions that you were present at, you and Mr. George Bouchard, I think you said, that you discussed the formation or discussed the transfer, or there was discussed, a transfer of the synthetic [281] rubber contract? A. That is correct.

Q. Was there any discussion as to consideration?

A. Not specifically. I think everyone felt any nominal consideration that you would have in any document. Most of our discussions were around

(Testimony of Claud L. Cameron.)

the mechanical problems that we were going to be confronted with in getting the consent of Rubber Reserve and/or Minnesota.

Q. As part of this overall deal of selling assets and transferring the contracts?

A. That's correct.

Q. Now, Mr. Cameron, Mr. Bouchard is the gentleman in the courtroom who was then the attorney for Mr. Davis? A. Correct.

Q. He is in the courtroom here? A. Yes.

Q. You testified that the permission of the RFC had not been obtained, never was obtained. Will you state whether or not, nonetheless, all the payments were made from the Minnesota Mining & Manufacturing Company to Bay Rubber?

A. Yes, except those that went—up to the period through January 15, '41 (sic.) that were made to Pacific.

Q. But I mean payments under the contracts were made notwithstanding that the consent of the RFC for the transfer was not obtained? [282]

A. That is correct.

\* \* \* \* \*

Q. Has the contract now been terminated?

A. Yes, sir.

Q. And fully paid up? A. Yes, sir.

Q. One further question for clarification: I think you have testified that all payments that went to Pacific for assets, including the \$5,000 consideration, was deposited in your trustee account?

A. Yes, sir.

(Testimony of Claud L. Cameron.)

Q. Payments under the synthetic rubber contracts made to Bay, were they similarly deposited?

A. No, sir.

Q. And how were they handled?

A. They were deposited in the Bay Rubber Co. bank account.

Q. And that applies to all payments except under the synthetic rubber contracts except those that were made before January 15, 1951? [283]

A. Yes, sir, and subsequently a substantial amount of those payments were disbursed to Mr. Poncelet Davis and accepted by him.

The Court: What is that last?

The Witness: And accepted by him.

Mr. Dinkelspiel: We will bring that out in our case-in-chief, if your Honor please.

#### Cross Examination

Q. (By Mr. Herndon): Mr. Cameron, just one further question, please, and we will be finished.

I would like you to state specifically again the individuals who were present at the conference you just referred to held in January 5, 1951 at the offices of the Pacific Rubber Company in answer to Mr. Dinkelspiel's question. Who were the individuals present when that was discussed?

The Court: When what was discussed?

Mr. Herndon: The transfer of the contract was discussed, Minnesota contract.

A. My participation was with Mr. Condrey and Mr. Bouchard.

(Testimony of Claud L. Cameron.)

Q. (By Mr. Herndon): Did you not state that there was a discussion held on January 5, 1951, in connection with the transfer of the Minnesota contract to Bay Rubber Co.?

A. That's the one I am referring to, sir.

Q. Again, please, between whom, which individuals, to your knowledge, now, if you know, was that discussion held? [284]

A. Specifically in my presence, with John Condrey and George Bouchard.

Q. John Condrey and George Bouchard?

A. Yes.

\* \* \* \* \*

### GEORGE BOUCHARD

called as a witness by the plaintiff; sworn.

The Court: State your name, please.

The Witness: George Bouchard.

### Direct Examination

Q. (By Mr. Clark): You are a member of the State Bar of California, are you not, Mr. Bouchard? A. I am.

Q. And your office is where?

A. In Los Angeles.

Q. How long have you been a member of the State Bar of California? A. Since 1928.

Q. Practicing in Los Angeles since that time?

A. Yes, sir.

Q. In 1951 you represented Robbins Tire & Rubber Co. as its [285] attorney in the various matters in California, did you not? A. I did.

(Testimony of George Bouchard.)

Q. You heard the testimony given from the witness stand by Mr. Cameron just a few minutes ago about a conversation that he participated in with you and John Condrey in Oakland at the office of Pacific Rubber Company on June 5, 1951, did you?

A. January 5.

Q. Did you participate in that conversation?

A. I did not.

Q. Did you, on January 5 or at any other time prior to October 1952, discuss the Bay Rubber—the transfer of the Minnesota synthetic Mining contract to Bay Rubber Co.? A. I did not.

Q. Anywhere? A. Nowhere.

Q. Was the matter of the transfer of the Bay Rubber—of the Minnesota synthetic Mining contract to Bay Rubber mentioned at all in your hearing by anybody on January 5, 1951?

A. No, sir.

Q. What was the subject of discussion at the meetings that you were in on January 5, 1951, the principal subject?

A. The principal subject of discussion on the January 5th meeting related to an offer, a sealed offer that Inland Rubber Company had made to purchase all of the assets of Pacific [286] Rubber Company and the fact that Robbins Tire & Rubber Co., through Mr. Davis—

Q. Which was your client at the time, is that right?

A. That is correct,—had made or was to make a counter offer. And the upshot of that was the sub-

(Testimony of George Bouchard.)

ject of discussion at those all-day meetings at which I was present.

The Court: Who was to make a counter offer?

The Witness: Robbins Tire through Mr. Davis.

Mr. Clark: Robbins Tire & Rubber Co.

The Court: You mean Robbins Tire?

The Witness: Yes, your Honor, Robbins Tire & Rubber Co.

The Court: Or some subsidiary?

The Witness: No, that was a company. They have no subsidiaries, to my knowledge.

A. (Continuing): And the upshot of that was that Inland withdrew its sealed offer and Mr. Davis withdrew, or stated he had no offer to make, so neither of the deals went through.

Q. (By Mr. Clark): To your knowledge. When was the first time that the Minnesota Mining Company contract, the disposition to be made of it, was discussed in Oakland or anywhere else after January 5, 1951?

A. Well, it was discussed—well, the following week—we had been in Los Angeles the 6th and 7th of January—yes, I think the 6th and 7th of January and then we returned to San Francisco and we were here about the 12th— [287]

Q. Let me interrupt you a moment, please. You say "we." To whom do you refer?

A. Well, I refer to myself, Mr. Davis had left, and I was authorized to represent Robbins, Mr. Hedges, Cameron, Mr. Pauley, Mr. Ezra *Brien*.

Q. Who was he?

(Testimony of George Bouchard.)

A. He is a member of the Ohio bar and was president of Inland Rubber Company. I think those were all. Perhaps—no, I think those were all.

Q. Had all of those people, had they or had they not, all of them, been present at the meetings on January 5, 1951 in Oakland?

A. Let's see. Yes, they had been.

Q. When did they leave Oakland, if you know, to return to Los Angeles?

A. Well, we left Oakland, oh, I should say about 4:00 or 4:30 in the afternoon.

Q. Of what day?

A. Same day, January 5, and returned to Los Angeles that night in Mr. Pauley's personal plane.

Q. Now, we go back and pick up where I interrupted you, please. The discussion of the disposition to be made of the Minnesota synthetic Mining contract. You started to say something about one week after. Will you pick up there and go ahead?

A. Well, it was when we returned to San Francisco, the 12th and 13th, and we were here through the 15th or 16th, that the matter was discussed as to what should be done with this synthetic contract in the event that RFC objected to Pacific Rubber Company continuing any participation because it was in dissolution. That matter was discussed.

Q. And was the result of that discussion reduced to writing?      A. It was.

Q. I hand you Plaintiff's Exhibit 22 in evidence and ask you to state whether or not that is the writ-

(Testimony of George Bouchard.)  
ing and agreement that resulted from the meetings  
that you have testified to as having occurred last.

A. Yes, sir. [289]

\* \* \* \* \*

Q. (By Mr. Clark): I hand you Plaintiff's Exhibit 2 in evidence and Plaintiff's Exhibit 3, in order to save time. Will you please examine them and let me ask you some questions about them. Examine the signatures particularly.

A. You said to examine the signatures?

Q. Yes. A. These are not signed.

Q. Not all of them. Well,—

A. This is a copy.

Q. All right. Exhibit 2 is the so-called partnership agreement with Bay Rubber Co., is it not?

A. It is.

Q. Were you present when that was executed?

A. Yes, I was.

Q. When did you first hear—

A. (Interrupting): May I qualify that to this extent, Mr. Clark?

Q. Yes.

A. I was present when it was executed by Mr. Pauley and Mr. Davis and Mr. Hedges. I don't believe that on the—because it was executed by them on the 7th day of January, I think it was signed perhaps by the others later who were [291] not present at this meeting.

Q. The instrument, you will notice, is dated January 8th. A. That's right.

Q. You say Mr. Davis and two or three others

(Testimony of George Bouchard.)

whose names you mentioned executed it on January 7?

A. Mr. Pauley, Mr. Davis, Mr. Hedges executed it on that day. Mr. Booz was not there nor Mr. Condry nor Mr. Cameron, and I don't think Mr. Pagen was there.

Q. Do you recall when Mr. Davis left Los Angeles?

A. Yes, he left the night of January 7.

Q. When did you first hear of the name Bay Rubber or Bay Rubber Co.?

A. I heard that such a company was to be formed on January 6th, 1951.

Q. From whom did you hear that?

A. I heard it from Mr. Bryan, who was the president of Inland; Mr. Hedges was present. Those two I remember definitely. Mr. Pauley and Mr. Davis were there for a little while; not too long on that first day of January 6th.

Q. Did you participate in the drafting of the articles of partnership?

A. I had nothing to do with the drafting of them, no.

Q. Well, you say that as if you had something to do with some part of it.

A. No, I had nothing to do with the drafting. The drafting [292] was done by Mr. Hedges and Mr. Bryan. They were submitted to me when they were prepared.

Mr. Clark: I am not pursuing anything with respect to Exhibit 3.

(Testimony of George Bouchard.)

Q. You were a director for a while, at any rate, of Pacific Rubber Company, were you not?

A. Not of Pacific Rubber Company. Pacific Tire & Rubber Company.

Q. Pacific Tire & Rubber Company; I'm wrong about that. Will you please state the circumstances in which you first heard of the transfer of the Minnesota synthetic Mining agreement to Bay Rubber Co. and the time when you first heard it, or the date, if you can?

A. The first time that I learned about it was approximately the 28th of September, 1952. I was in Oakland in the office of Pacific Tire & Rubber Company and I asked to see the minute book of Pacific Rubber Company. Mr. Condrey was not there on that day and the book was locked up, so I didn't see it on that day. But I went back on the next day, the 28th, Mr. Condrey showed me the minute book and permitted me to make whatever use of it I wanted and I read the minutes on the very first, the very first minutes in the book.

The Court: The minutes of the Pacific Rubber?

The Witness: Yes, sir.

The Court: That is Exhibit 15 here. [293]

Mr. Clark: Yes, sir.

A. (Continuing): The very first minutes in the book, as I recall it, were the minutes of May 21, 1951 in which the resolution was adopted by the two directors, Condrey and DeSellem, transferring the contract to Bay Rubber Co.

Q. (By Mr. Clark): At the risk of some repeti-

(Testimony of George Bouchard.)

tion, that is the first information you had of the transfer of the Minnesota synthetic Mining agreement?      A. That is correct.

Q. To Bay Rubber.      A. That is correct.

Q. Had you ever heard from any source prior to that time that the transfer would be made?

A. I had not.

Q. Had you come into contact between January 5 and May 21, 1951 with Mr. Pauley or Mr. Cameron or Mr. Condrey, Mr. DeSellem, Mr. Hedges?

A. Very frequently.

Q. Had you discussed business matters relating to Pacific Rubber Company, Bay Rubber Co., Pacific Tire & Rubber Company, with them when you met them?

A. I discussed matters in connection with Pacific Tire & Rubber Company.

Q. Pacific Tire & Rubber Company?

A. Yes. I don't think I ever discussed anything pertaining [294] to—

Q. (By Mr. Clark): How frequently would you say you saw or how many times would you say you saw those gentlemen that you discussed and talked with them from January 5 to May 21, 1951?

A. Well, I would say quite frequently, Mr. Clark, I am sure of at least once a month because we held directors' meetings of Pacific Tire & Rubber Company once a month at Oakland, and I think during that period I was present at all of them. I don't think Mr. Pauley was present at all of them; I'm sure Mr. Cameron was and that Mr. Condrey

(Testimony of George Bouchard.)

was there in the plant. I'm not sure that Mr. Hedges was present at all of them, but I saw them frequently.

Mr. Clark: Will the Court indulge me just a moment?

Q. When you first saw the minutes of May 21, 1951, after you had seen those, what did you do, Mr. Bouchard, with respect to the information that you had gained?

A. Well, I returned to Los Angeles and I telephoned Mr. Davis at Akron.

Mr. Clark: That's all. [295]

#### Cross Examination

Q. (By Mr. Dinkelspiel): Was it on September 28th, 1952 that you first saw the minute book?

A. I wouldn't say that was the first time I ever saw it, Mr. Dinkelspiel.

Q. Well, the first time that you saw the minutes of the meeting of May 21, 1951, is that correct?

A. I think that is correct, yes.

Q. And was there any particular reason why you were looking through the minute book on that date?

A. Yes.

Q. What was that reason?

A. Well, the reason was Mr. Davis had—was becoming dissatisfied with the operation of the new company, Pacific Tire & Rubber Company, as we felt that they were in default on some of their obligations to Robbins, and I wanted to examine the minute book of Pacific Rubber Company to see

(Testimony of George Bouchard.)

what, if anything, they contained with reference to the agreement to transfer by the stockholders.

Q. And subsequent—

The Court: Who was becoming—you say Davis was becoming dissatisfied; at what?

A. At the operation of the new company, Pacific Tire & Rubber Company, which had purchased the assets of Pacific Rubber.

The Court: Why did you look at the minutes of Pacific [296] Rubber?

A. Because I wanted to see what the minutes contained with respect to the sale to the new company, if there was anything. Plus the fact that we had some problems with respect to a tax refund and I wanted to see what the minutes showed as to that.

Q. (By Mr. Dinkelspiel): You were preparing a lawsuit, weren't you?

A. Well, we were talking about. I don't think any papers had been prepared, Mr. Dinkelspiel.

Q. You were talking about it for several years, about filing lawsuits, weren't you? A. No, no.

Q. I will withdraw that question.

Mr. Bouchard, the Robbins Tire & Rubber Co. was one of the stockholders of Pacific Rubber Company, right? A. Correct.

Q. And was there money owing to the Robbins Tire & Rubber Co. at the time you made this investigation of the minute books of Pacific Rubber Company? A. Was there money owing?

Mr. Clark: By whom, if I may ask?

Q. (By Mr. Dinkelspiel): From the liquidation.

(Testimony of George Bouchard.)

A. See if I get your question, Mr. Dinkelspiel. Did Robbins [297] Tire & Rubber Co. have any monies—

Q. Monies owed to it, to your knowledge, at the time you examined the Pacific Rubber Company books for the first time.

A. Not to my knowledge.

Q. I see. Well, what was there in the Pacific Rubber Company books which could possibly interest you in behalf of your clients in connection with the Pacific Tire & Rubber Company?

A. I don't know. That's what I wanted to examine them for, you see.

Q. But as one lawyer to another, how could there be anything in the Pacific Rubber Company books that would in any way interest you or your clients in respect to the Pacific Tire & Rubber Company? A. I don't know.

Q. Well, that's a good answer.

Now, Mr. Bouchard, whom did you represent at that moment? A. At which moment?

Q. That moment— A. In October?

Q. That moment when you opened the minute book for the search of something you knew not what? You remember? A. Yes.

Q. Whom did you represent? [298]

A. Robbins Tire & Rubber Company.

Q. Did you represent Mr. Davis?

A. I hadn't done anything for Mr. Davis—I hadn't done anything for Mr. Davis individually

(Testimony of George Bouchard.)

since the partnership agreement was drafted and signed by him.

Q. That was in January of 1951, January 7?

A. That is right. I think that's a correct statement.

Q. And from that time on you had done nothing for Mr. Davis? A. Nothing that I recall.

Q. You didn't represent him in his tax difficulties or anything of that kind? A. I did not.

Q. Did you represent him on the occasion that this document, Exhibit 22, January 13, 1951 was signed?

A. Is that the last exhibit, Mr. Dinkelspiel?

Q. Where you signed for Robbins Tire & Rubber.

A. Well, I can't say, Mr. Dinkelspiel, except to this extent: I don't know of anything that I did for Mr. Davis personally in a legal capacity after the partnership agreement was signed on January 7.

Q. To and including the present time?

A. I believe that is true.

Q. I assume you are paid compensation as counsel for Robbins Tire & Rubber Co.? [299]

A. Yes, sir.

Q. And that company pays your compensation?

A. It does.

Q. You are telling me that Mr. Davis hasn't paid you any compensation since January 7, 1951?

A. I believe that's true, Mr. Dinkelspiel. If he has, I don't recall what it is. If you have anything

(Testimony of George Bouchard.)

hat indicates it, I will certainly know. But I don't recall anything.

Q. Do you distinguish carefully between the source of your payments as to whether it is Poncet Davis or Robbins Tire & Rubber Co. by Poncet Davis. A. Well, on my books I do, yes. [300]

Q. All right. Did you have any work to do in connection with the partnership agreement after it came into effect, did you consult with anybody in the interests of anybody?

A. Yes. I consulted, yes. I consulted with Mr. Pauley and I think I was employed by Mr. Pauley in connection with a proposed matter for Bay Rubber Company.

Q. Is that the only occasion you did any work in connection with Bay Rubber Company?

A. Assuming—it is the only one offhand I think of, Mr. Dinkelspiel. [301]

\* \* \* \* \*

Q. (By Mr. Dinkelspiel): Mr. Bouchard, directing your attention to the Bay Rubber Company, did you at any time give any legal advice or take any legal action in behalf of anybody in relation to matters of Bay Rubber Company?

A. Well, I gave Mr. Davis some advice the day that he signed it. I advised him not to sign it. I gave some advice to Mr. Pauley, who employed me in behalf of Bay, with respect to a matter they were contemplating but didn't go through with it.

I don't recall anything else, Mr. Dinkelspiel.

Q. You say you recall of no services rendered

(Testimony of George Bouchard.)

anybody except possibly for Mr. Pauley and the advice you gave Mr. Davis at the time the Bay Rubber Company was formed?

A. I believe that is true. I can't think of another thing I did for Mr. Davis.

Q. Now, let me direct your attention to the date of January 5, 1951, and ask you whether it is not a fact that Mr. Davis and you were both at the rubber company plant at Oakland for the better part of that day? A. That's right.

Q. There were numerous—as Mr. Cameron testified, there were numerous conversations, caucases, and what have you, carried on all through the day, were there not? A. That's correct.

Q. Mr. Pauley and Mr. Davis in one room, [302] and you and somebody else in another room, and constant conversation, right?

A. That's correct.

Q. Now, the main subject matter of the conversation was, was it not, the transfer of the assets of Pacific Rubber Company?

A. That's right.

Q. And I believe you testified that there was an offer from Midland Rubber Company, a sealed offer, right? A. That's correct.

Q. You said for all of the assets, did you not, in your testimony?

A. Well, I may have said "all the assets."

Q. You don't mean that, do you?

A. Well, I don't mean that, and I never saw the offer. It was sealed.

(Testimony of George Bouchard.)

Q. All right. You know, though, don't you, that it was for all of the assets except the synthetic rubber company contracts?

A. Well, I think that is a fair statement.

Q. That is a fair statement, isn't it?

A. Because I know that Robbins would not sell their interest in the synthetic contract. Now, I never saw the offer because it was sealed, that's all.

Q. You say that Robbins would not sell their interest. At any price? [303]

A. I didn't say that. But they were not for selling in this instance as part of the assets.

Q. At any price?

A. Oh, I don't know that. Everybody has got a price, Mr. Dinkelspiel, at which they will sell.

Q. Was it Robbins who wouldn't sell or Inland who wouldn't buy?

A. Well, I know Robbins would not sell. I don't know about Inland.

Q. You also know that the synthetic rubber contracts were kept out of that offer because Inland couldn't buy?

A. Well, I knew they were kept out of the offer. Now, I don't know what the reason was from Inland's point of view.

Q. You also knew that the rubber group, Mansfield-Inland — that group — had another synthetic rubber plant in operation?

A. No, I didn't know that.

Q. You did not know that?

A. No, I did not.

(Testimony of George Bouchard.)

Q. You never heard that at any time?

A. Yes, I heard it, but I didn't know it then.

Q. When did you first hear that?

A. Oh, I don't know, Mr. Dinkelspiel, when I first knew it.

Q. All right. Let me call your attention [304] to this letter of Edwin Pauley, approved and accepted by Poncet Davis, January 7, 1951, Exhibit 29.

This happens to be a copy, but if counsel won't object to me using it—it is a carbon—

Mr. Clark: It is in evidence already as the original.

Mr. Dinkelspiel: Yes.

Q. You have seen that before and you have testified with respect to it? A. Yes.

Q. Now, it is a fact, is it not, that this letter refers to ten percent being held by Pagen as trustee? A. Right.

Q. For officials, it says, of Minnesota Mining and Manufacturing Company? A. Right.

Q. Directors, employees or nominees, correct?

A. Correct.

Q. A ten percent interest in Bay Rubber Company, right? A. Right.

Q. A partnership that had been formed on January 7. So the same day, correct? A. Right.

Q. You know, do you not, that subsequently this ten percent interest was transferred to a man named Hayes, part individually and part as trustee? [305]

(Testimony of George Bouchard.)

A. Not the ten percent.

Q. Nine percent.

A. Eight percent. Four percent to Hayes and four percent to Hayes, trustee.

Q. I see. And Mr. Hayes—

The Court: What was that?

A. Four percent to J. L. Hayes individually and four percent to J. L. Hayes, Trustee.

Q. (By Mr. Dinkelspiel): And Plaintiff's Exhibit No. 3 so provides, does it not? I show it to you, directing your attention to page 3 of the document (handing to witness). A. Yes, sir.

Q. And I think—

The Court: Is that the amended articles?

Mr. Dinkelspiel: Amended articles, Your Honor, December 28, 1951.

Q. Now, Mr. Hayes signed in both capacities, did he not? A. Apparently so.

Q. Now, did you ever see these amended partnership articles before? A. Oh, yes.

Q. Well, I wouldn't be surprised, Mr. Dinkelspiel, but what I saw it at the time it was drafted.

Q. Why did you see it?

A. Well, I'm just guessing now— [306]

Q. Whom did you represent?

A. Well, I didn't represent anyone in connection with the execution of this, but I had represented Mr. Davis and I think when this was drafted perhaps Mr. Hedges gave it to me or maybe Mr. Davis sent it to me. I frankly don't know.

(Testimony of George Bouchard.)

Q. You did not represent Mr. Davis, then, did you?

A. I didn't get any compensation for anything I did on that. I don't think I represented him in connection with it. I may have written him a letter and enclosed it. I really don't know, Mr. Dinkel-spiel.

Q. You didn't have much to do with the partnership agreement after its execution, did you?

A. That's correct.

Q. You didn't know then why a director, official of the Minnesota Mining and Manufacturing Company, was given a participation in this partnership, did you?      A. Oh, yes, I knew.

Q. You did know?      A. Yes.

Q. And that was part of what you found out when?

A. I found that out on January the 7th, this document that you have just shown me signed by Mr. Pauley and Mr. Davis.

Q. All right. You also knew that Mr. Hayes—. You knew on December 28, 1951 that Mr. Hayes was an official of the Minnesota Mining and Manufacturing Company? [307]

A. I knew he had some connection.

Q. Some connection with the company?

A. Yes.

Q. Now let us get back to the minute book and your investigation of the minute book of Pacific Rubber Company in behalf of your interest in Pacific Tire & Rubber Company, and you testified you

(Testimony of George Bouchard.)

saw the minutes of May 21, 1951. I assume, to reach the minutes of May 21, 1951, you perused the minutes prior to that time, isn't that correct, or did you just happen to hit on May 21?

A. No, I saw several of the minutes on that day.

Q. Did you read all of the minutes prior to that time?

A. I may have done so, Mr. Dinkelspiel.

Q. Don't you think that you must have done so if you were on an investigating tour?

A. I think probably I did.

Q. Well, let's assume that you did, for the purpose of the next question, and if you didn't you can correct me. Did you also read the by-laws?

A. I do not think that I did.

Q. And I suppose you did not bother reading the articles of incorporation?

A. I don't think so.

Q. Referring to the minutes of the first meeting, the organization meeting as we lawyers sometimes call it, the first [308] meeting of the board which has been lettered in pencil in the upper right-hand corner "1" to "8." I will ask you whether those minutes were the minutes you saw when you read that book, if you can tell me?

A. Mr. Dinkelspiel, frankly I don't know.

Q. You can't answer me now whether or not those were the minutes or some other minutes were there instead?

A. I really couldn't tell you, I frankly can't.

Q. I see. But on this date, in 1952, you recollect

(Testimony of George Bouchard.)

you went through the minute book for the purpose of finding out whether there was something that interested your interests, let's say, in Pacific Tire & Rubber Company? A. Yes.

Q. And you happened on something, I suppose, that interested Mr. Davis, or Robbins Tire & Rubber Company, is that right?

A. Well, I found two things that I thought were of interest in the book.

Q. Now, to get back, Mr. Bouchard, to your conversation with Mr. Davis which you mentioned a few minutes ago before or about the time he assigned the Bay Rubber Company contract. It is true, is it not, that you said to Mr. Davis at that time—and it is in the presence of others so it is not in the nature of privileged communication—that he was foolish to sign the Bay Rubber contract because that deprived him of [309] a voice in management, isn't that correct? A. That is correct.

Q. And Mr. Davis signed the contract in your presence? A. That is right.

Q. All right. Immediately after that advice was given?

A. No. Quite some time after, as a result of a conversation between Mr. Davis and Mr. Pauley and myself.

Q. Now, let's get this straight. You gave this advice at what time of day, if you can recall, and where?

A. I gave the advice to Mr. Davis from my home on January 7, which was a Sunday morning, and I

(Testimony of George Bouchard.)

called him at the Ambassador Hotel where he was staying. He had not been in Mr. Pauley's office the afternoon, where this contract was shown to me, and we were to meet at Mr. Pauley's office. I called him from my home at the hotel and told him about the contract and that I had read it and that in my judgment he was foolish if he signed it because it deprived him of any voice in management.

The Court: You are speaking of what contract?

A. The articles—the Bay Rubber partnership agreement.

Q. (By Mr. Dinkelspiel): All right. Now, that, of course, was out of the presence—. That is advice you gave Mr. Davis not in the presence of Mr. Hedges or Mr. Pauley; that advice was over the telephone to Mr. Davis?

A. On that occasion, it was.

Q. All right. [310]

There was another occasion, was there not, which was immediately before the signing of the partnership articles? A. That's right.

Q. When you repeated that advice?

A. That is right. I got there before Mr. Davis and told Mr. Pauley I had given Mr. Davis that advice. And then I gave it to him in the presence of Mr. Pauley and Mr. Davis and myself at Mr. Pauley's office.

Q. And Mr. Hedges?

A. No, I don't think Mr. Hedges was present. I don't recall that he was present.

Q. You state positively that he was not?

(Testimony of George Bouchard.)

A. I won't say positively. He may have been. Mr. Hedges was there and he may have been present, I wouldn't be sure.

Q. Now, just before—and I mean an instant before Mr. Davis signed that document—you repeated you advice to him, did you not?

A. Well, I don't recall, Mr. Dinkelspiel. I had given it to him two or three times, and whether I repeated it the minute before he put his signature on the document, I don't know.

Q. Well, let's say closely connected in point of time with his signing of the document?

A. It might have been.

Q. What is your best recollection of it?

A. Well, frankly—. [311]

Q. It was or was not?

A. I frankly don't have any recollection about it. We were in Mr. Pauley's office for over an hour and a half talking about it, and I may have, when he put his name on it, stated: "I still think you are foolish to do it." I don't recall, maybe I did.

Q. Now, you stated that you did not represent Mr. Davis in any matter since January 7, 1951. Were you still friendly with him?

A. Mr. Davis?

Q. Yes. A. Yes.

Q. Did you see quite a bit of him? A. No.

Q. Did you do any work for Robbins Tire & Rubber?

A. I don't believe that I did. Well, yes, I did. I did some work for Mr. Davis, in this respect, Mr.

[Testimony of George Bouchard.)

Dinkelspiel, I never saw Mr. Davis after he left here on January 7 until he returned to California some time in October of '52.

Q. Is that when that litigation was going on?

A. No, it was—the litigation didn't start until November, I believe.

Q. And then you were here and you were in the Federal Court here about, some time after November, were you not? A. Yes, we were.

Q. In matters involving Robbins Tire & Rubber? [312]

Q. And Poncet Davis?

A. No, I don't think Mr. Davis was in it.

Q. Did Mr. Davis ever mention to you that he had received substantial sums of money from Bay Rubber Company? A. He never did.

Q. He never told you that?

A. Well, he didn't tell me at the time he received them. I later learned that he had, yes.

Q. How much later?

A. Well, my best recollection that I now have is that I learned that he had a distribution from Bay Rubber in the year 1951, and I think I learned that, oh, during the course of that litigation, which was subsequent—which was in 1953.

Q. All right. But you examined, I understand, the books of Pacific Rubber Company on September 28 or thereabouts, in 1952, and at that time you can across a transfer of the—the minutes, rather, with respect to the transfer from Pacific Rubber Company to Bay Rubber Company of synthetic

(Testimony of George Bouchard.)

rubber contracts. Did you tell Mr. Davis of your discovery?

A. I did, about the first of October of '52.

Q. About the first of October, 1952?

A. That is correct.

Q. And were you in communication with him on that subject matter on more than one occasion after that time?

A. Well, I haven't any definite recollection of it, but [313] I wouldn't be surprised if I did.

Q. Mr. Davis was then president of Robbins Tire & Rubber, was he not? A. He was.

Q. And he remained president up to the present time? A. That's right.

Q. He still is, right? A. Yes.

Q. Now, this particular lawsuit was filed, was it not, more than two years after your discovery?

A. It was filed the summer—yes, that's right.

Q. All right. Now, Mr. Bouchard, one more question, is it not a fact to your knowledge that Bay Rubber Company and Inland Rubber Company caused Pacific Tire and Rubber Company, of which you are a director, to be formed?

A. That's right.

Q. To form and to acquire assets, the plant across the Bay and other assets, from the Pacific Rubber Company? A. That's right.

Q. Indirectly through the dissolution and the trusteeship of Mr. Cameron? A. Yes.

The Court: Just a moment. Read those last two questions.

(Testimony of George Bouchard.)

(The Reporter read: "Is it not a fact to your knowledge that Bay Rubber Company and Inland Rubber Company [314] caused Pacific Tire and Rubber Company, of which you are a director, to be formed?

A. That's right.")

The Witness: Let me qualify that, if I may. The answer is, as I gave it to you, Yes, I knew that Bay and Inland did, but I think if you will look at the agreements in evidence—I have forgotten their numbers—they are dated January 7, '51—the agreement to form Pacific Tire & Rubber Company is not an agreement between Inland and Bay Rubber Company. I don't believe you will find the word "Bay Rubber Company" used in the documents. I think the agreement was between Inland Rubber Company and Edwin Pauley and Poncet Davis and I have forgotten who else might have been named. I think you will not find the name "Bay Rubber Company" used in the agreement.

Q. (By Mr. Dinkelspiel): Well, there was an agreement among interested parties to form Pacific Tire & Rubber Company, which was in turn to acquire the plant and facilities of Pacific Rubber Company? A. That's correct.

Q. Passing for the moment who did it, the documents speak for themselves. A. Yes.

Q. Now, is it not a fact that one-half of the group that was going to form this new company was the so-called [315] Mansfield Tire & Rubber Company group? A. That is right.

(Testimony of George Bouchard.)

Q. A wholly owned subsidiary of which is Inland?      A. That's right.

Q. And is it not a fact that Mr. Hoffman and Mr. Bryan, Mr. Hoffman, vice-president of Mansfield, and Mr. Bryan, attorney and president of Inland, said that they would not form this new corporation if Poncet Davis had any part in the management?

A. They didn't say it to me prior to January 6, 1951. They apparently had said it.

Q. And you knew they said it?

A. I knew they had said it, but I didn't know that until January 6, 1951.

Q. And that's the reason Bay Rubber Company was formed and Mr. Poncet Davis was only a limited partner of it?

A. That is absolutely right.

Q. So that he would have no part in the management?      A. That is absolutely correct.

Q. And is it not also true that the synthetic rubber contracts could not be carried on by the stockholders in dissolution, and that when the arrangements were made for the transfer of assets to Pacific Tire & Rubber Company it was similarly agreed that the synthetic rubber company contracts should go to Bay Rubber Company? [316]

A. No, that's not so.

Mr. Dinkelspiel: That is all.

I may ask one or two questions after the recess, your Honor. I assume your Honor wants to recess now?

(Testimony of George Bouchard.)

The Court: All right. Take the recess until two p.m.

(Thereupon an adjournment was taken until 2:00 o'clock p.m. this day.)

Afternoon Session, Tuesday, December 20, 1955

At 2 O'Clock

\* \* \* \* \*

Mr. Dinkelspiel: I have a few more questions of Mr. Bouchard. I want to refer Mr. Bouchard to the meeting of the Board of Directors of the Pacific Rubber Company in Exhibit 15 and the minutes dated the 21st day of May, 1951, which I think you testified to as having been seen by you when you examined the minute book in September of 1952.

A. These are the minutes.

Q. Yes. Now, you will note that the minutes begin with the words "A regular meeting." In fact, the title is, "Minutes of regular meeting of Board of Directors, Pacific Rubber Company." Did that cause you to examine the by-laws or other minutes to determine what constituted a regular meeting of the Board of Directors?

Mr. Clark: At what time; any time, Mr. Dinkelspiel? [317]

Mr. Dinkelspiel: Well, I mean at the time he ran across this when he was examining the minute book.

A. Well, I did examine the by-laws, Mr. Dinkelspiel. Now, whether I examined them on that day—maybe I did. I have examined the by-laws.

(Testimony of George Bouchard.)

Q. And the provision with respect to regular meetings as set forth in the by-laws, you examined that, did you? A. Yes, I have.

Q. Did you at that time, if you can recollect, on the 21st day of May, 1951, examine the by-laws?

A. Well, I didn't examine them on the 21st day of May of 1951.

Q. I beg your pardon. At the time when you saw the minutes of the 21st of May, 1951, which was, as I understand it, September of 1952, did you then examine the by-laws?

A. Frankly I don't believe I did on that day.

Q. I see. How long after would you say you examined the by-laws?

A. I don't think that I examined the by-laws until May of 1955 when I again had the minute book in my possession.

The Court: When, 1955? A. May of 1955.

Q. (By Mr. Dinkelspiel): By the way, when you examined the minutes of the Pacific Rubber Company did you also look at the minutes of May 18—well, I think it is the second— [318] Pardon me, your Honor.

Did you also examine the minutes entitled "Minutes of regular meeting of Board of Directors, Pacific Rubber Company," and starting, "Regular meeting of Board of Directors, Pacific Rubber Company held on the 15th day of January, 1951."?

A. I did. When I examined this book in about the first of October, 1952, I read all of the minutes in the book.

(Testimony of George Bouchard.)

Q. And you knew then that there were a set of minutes that purported to authorize the assignment to Mr. Pauley of a 10 per cent interest in the proceeds of the synthetic rubber company contracts?

A. Yes, that is one of the two things that I found that I thought was interesting.

Q. So the two things you found of interest, you say, two things of interest were the assignment of the contracts to Bay Rubber Company —that is, the Board of Directors' purported authorization, and the Board of Directors' purported authorization payment to Mr. Pauley of 10 per cent of the proceeds of those contracts? A. Yes, sir.

Q. And those were of interest to whom?

A. Well, they were of interest to me at the time I read them.

Q. In what capacity, any legal capacity, or were you acting for anybody? [319]

A. Well, as having represented Robbins and Mr. Davis.

Q. You also represented Bay Rubber, didn't you?

A. I didn't—let's see, in October, 1952—

Q. So as not to mislead you, my examination indicates you did in January of 1952.

A. I did some work for Bay Rubber Company some time the early part of 1952.

Q. All right. Now, is it a fact that about September of 1952, within a very short time thereafter, you prepared a complaint based upon some of this information which you found in the minute book?

(Testimony of George Bouchard.)

A. No, I don't think the information in the complaint was, Mr. Dinkelspiel, as a result of what I found in the minute book.

Q. Well, I mean, when did you first prepare a complaint, either the original or a draft of the complaint which is used in this action?

A. The present action?

Q. Yes.

A. The draft of this complaint that is used in this present action was drafted in Mr. Clark's office in, I think it was May of 1953.

Q. May of 1953? A. Yes.

Q. And was filed in December of 1954? [320]

A. Correct.

Q. Now, one question I overlooked on that January 5, 1951 meeting where you testified in contradistinction to Mr. Cameron's testimony that there was no discussion with you and Mr. Cameron, or in your presence, about the assignment of these contracts, these synthetic rubber contracts; that's correct, you so testified? A. That's right.

Q. Now, was there any statement with respect to their assignment made in your presence that day by a Mr. DeSellem or in the presence of Mr. DeSellem and yourself? A. No, there was not.

Q. Now, Mr. Bouchard, I understand that you obtained—you saw these minute books in September of 1952. Now, it's true, is it not, that in or about the month of July, 1953, in behalf of a client whom I think you said was Mr. Davis, you asked for an audit of the Bay Rubber Company?

(Testimony of George Bouchard.)

A. July of '53; yes, that's correct.

Q. July or August or June of 1953.

A. It was actually made in August, but I think probably it was July we requested it.

Q. And an audit was made and an original or copy delivered to you by Clarence Bodo; is that not correct? A. That's correct.

Q. By whom—in whose behalf did you make that demand? [321]

A. I made that in behalf of Mr. Davis.

Q. Well then, you were representing Mr. Davis then? A. Yes, I was.

Q. That is in 1953? A. That's right.

Q. Is it also true that later you asked for a further report and audit for the period from January 1, 1953 to October 31, 1954?

A. That's correct.

Q. And you received both those audits, did you not? A. I did.

Q. That was also a demand made by you in behalf of Mr. Davis, was it not?

A. Yes, it was.

Q. At that time you were representing Mr. Davis? A. Yes.

Q. They were audits of Bay Rubber Company, were they not? A. They were.

Q. Now, you have done some work for Bay Rubber Company, have you not?

The Court: Did you say they were ordered by Bay Rubber?

Mr. Dinkelspiel: Audits of Bay Rubber.

(Testimony of George Bouchard.)

Q. You have done some work for Bay Rubber Company professionally, haven't you?

A. Yes. [322]

Mr. Clark: He has already testified he has.

Mr. Dinkelpiel: All right, it's purely preliminary.

Q. Now, isn't it a fact that one of the legal jobs you did for Bay Rubber Company and for which you receive compensation was the preparation of a partnership agreement?

A. Yes, that's correct.

Q. And what was that partnership agreement?

A. Well, it was—when Bay Rubber Company was organized in January of 1951, one of the things the partnership thought it might ultimately do was to go into the mechanical rubber goods business. At some time later, I think it was the early part of 1952, Mr. Pauley employed me to draft a proposed partnership agreement between Pacific Tire and Rubber Company and Bay Rubber Company to go into the mechanical rubber goods business.

Q. May I interrupt you a second? I am sorry—as between Bay Rubber Company and Pacific Tire and Rubber? A. That's right.

Q. Yes. And you drafted such a partnership agreement?

A. I drafted a proposed partnership.

Q. A proposed partnership agreement?

A. That's right.

Q. You were compensated for by whom?

A. Bay Rubber Company.

(Testimony of George Bouchard.)

Q. By Bay Rubber Company? [323]

A. Yes.

Q. Now, at that time isn't it a fact that you knew that the Bay Rubber Company had, as part of its assets, the assignment of the synthetic rubber contracts?

A. I don't think so, Mr. Dinkelspiel.

Q. What other assets did it have except an interest in Pacific Tire and Rubber Company?

A. So far as I knew it didn't have any other assets, it just had the stock and debentures of Pacific Tire and Rubber Company.

The Court: Had what?

The Witness: Fifty per cent interest in the stock and debentures of Pacific Tire and Rubber Company.

Q. (By Mr. Dinkelspiel): That's all you thought it had at that time? A. That's right.

Q. That was when you drafted a proposed partnership agreement between Pacific Tire and Rubber and Bay Rubber Company?

A. That's correct.

Q. Was there a third proposed partner in that, Inland Rubber Company?

A. I don't think so, Mr. Dinkelspiel. I think that the proposed agreement was between Pacific Tire and Rubber and Bay. It was never consummated, but I don't believe Inland was a party, at least to the draft I prepared. [324]

Q. So at that time it is your recollection that the only assets Bay Rubber Company was its notes

(Testimony of George Bouchard.)

and stock, the notes and stock of Pacific Tire and Rubber Company?

A. I think that's correct.

Q. You don't know whether it had any income then or not from any source?

A. No, I didn't. I haven't—I am not sure just what the date of that employment was.

Q. Maybe I could help you on that.

A. If you could help me.

Q. I show you what purports to be a letter on the stationery of Bouchard & Brown dated January 24, 1952, addressed to Mr. Claude Cameron, with a statement for services rendered to that law firm. [325]

\* \* \* \* \*

A. That's correct. That is my letter to Mr. Cameron and that's my bill for services, and I'm sure it was paid.

Q. (By Mr. Dinkelspiel): Having seen this, does it recollect the time—does it bring back to your mind the time when the services were rendered?

A. Yes, services were rendered on January 7, 8 and 9 of January of 1952.

Mr. Clark: I think, your Honor please, we ought to have those two sheets marked for identification only.

Mr. Dinkelspiel: I will have them—

Mr. Clark: Unless you want to put them in evidence.

Mr. Dinkelspiel: I will have them done, in the

(Testimony of George Bouchard.)

interests of saving time I will ask the witness, while I am here, Mr. Clark, the nature of the services is disclosed also, is it not? [326]

A. That is correct.

Q. (By Mr. Dinkelspiel): What is that?

A. It's drafting or proposed partnership agreement on the 7th and on the 8th, eight hours at your office, that is Mr. Cameron's office, of Messrs. Cameron, Hoffman and others, and on January 9 a meeting in the Beverly Hills Hotel with the same group. The Mr. Hoffman I referred to is the president of Mansfield.

Q. Of Mansfield? A. That's right.

Q. And also Mr. Fleming, a telephone call to Mr. Fleming in Cleveland—he is with Mansfield too, —is he is attorney or accountant?

A. Mr. Fleming is an attorney in the firm of Baker, Hostetler and Sidlow, in Cleveland.

Q. Attorneys for Mansfield?

A. That's right.

Mr. Dinkelspiel: I will have this marked for identification.

The Court: Exhibit D for identification.

(Whereupon proposed partnership agreement was marked Defendant's Exhibit D for identification.)

Q. (By Mr. Dinkelspiel): Does the fact of the communication with the law firm of Baker, Hostetler and Fleming, is it—or Baker and Hostetler, is it? [327]

A. Baker, Hostetler and Sidlow.

(Testimony of George Bouchard.)

Q. And with Mr. Fleming indicate to you whether or not Mansfield were a party to the partnership, or involved in it?

A. Yes, I am sure it was. Mr. Fleming is one of the tax counsel in that firm, and that was what we were talking about.

Q. Yes. And there were some tax problems involved in the formation of this partnership?

A. Well, Mansfield wanted to be sure that there were none that were overlooked.

Q. Just, Mr. Bouchard, and without any attempts to suggest any misstatements on your part, but if there were tax consequences involved in what was doing, proposed to be done, wasn't it something you felt necessary to know what the income was of the client you represented in that partnership setup?

A. Stated as you do you would think the answer would be yes, but—

Q. I had that in mind.

A. Yes. But that wasn't a problem on our side, it was just a question on Inland's side, or Mansfield, whichever it was.

Q. One last question. In behalf of Mr. Davis or the Robbins Tire and Rubber Company have you made demand to set aside the transfers of those two synthetic rubber company contracts from Pacific to Bay Rubber?

A. Will you state that—may I have that again, Mr. Reporter?

(Record read.) [328]

(Testimony of George Bouchard.)

A. None other than this action.

Q. (By Mr. Dinkelspiel): None other than this action? A. That is correct.

Q. That would be your testimony with respect to anybody—nobody has made any demand except by this action?

A. Not to my knowledge, no. \* \* \* \* \*

### Redirect Examination

Mr. Clark: May it please the Court.

Q. On cross examination by Mr. Dinkelspiel you were asked about a statement in Exhibit No. 29 relating to the 10 per cent interest in Bay Rubber Company, it was to be set aside for officials and directors and nominees in Mansfield, and you replied that you knew what that was for. What was it for?

Mr. Hedges: It was in reference to Minnesota, counsel; you said Mansfield.

Mr. Clark: That's a misstatement. I am sorry, Minnesota Mining and Milling Company.

The Witness: And it's 8 per cent and not 10.

Q. (By Mr. Clark): That's right.

A. Yes. At the time Bay Rubber Company was formed it was talked about and there was some contemplation that Bay Rubber Company would go into the mechanical rubber goods business. [329]

Q. Is that different from the synthetic rubber business? A. Oh, yes, yes.

Q. All right.

A. And Mr. Pauley and Mr. Davis thought it

(Testimony of George Bouchard.)

would be advisable to set aside an interest, which they decided on at 8 per cent, for the officers and directors and officials of Minnesota Mining Company to create in them and have their good will and perhaps knowhow if they went into that business out here on the coast.

Q. Why did they want the knowhow of those officers?

Mr. Hedges: Calls for the conclusion of this witness.

Q. (By Mr. Clark): If you know.

A. Well, I could only surmise that, Mr. Clark; Bay Rubber didn't have any knowhow of their own.

Q. You don't know what business Minnesota Mining and Milling had?

A. Yes, they are in—making Scotch tape and other mechanical—

Q. Is that a mechanical rubber business also?

A. I understand so, yes.

The Court: Is that the only reason you were told 8 per cent was to be given to these officers?

The Witness: Only reason I know of given, yes, your Honor.

Mr. Dinkelspiel: May we have the time and place, please, [330] when this information was given to this witness?

A. Yes, on the day that that document was signed, on January 7, I think it is, 1951.

Mr. Clark: That's correct.

Q. In response to a question of Mr. Dinkelspiel's, you stated that you found two things in the

(Testimony of George Bouchard.)

ninute books of interest. You have, as a result of he further cross examination, told what those two hings were of interest to you in the minute book of Pacific Rubber Company?

A. I think I have, yes.

Q. Yes. You were also asked—I have forgotten now the question was phrased, but your response was that there was a conversation among Pauley, Davis and yourself in Pauley's office in Los Angeles which resulted in the signing of some instrument by Mr. Davis. That was the partnership agreement that was signed, was it not? Tell us what that conversation was, where it occurred, who was present, and when.

A. It occurred on the morning of January 7, 1951, in Mr. Pauley's office, and the only persons who were present were Mr. Pauley, Mr. Davis and myself. I had told Mr. Pauley that I had advised Mr. Davis not to sign the agreement, but I didn't know what he was going to do about it. And we were there, I suppose, in Mr. Pauley's office, for a good part of an hour, at least, and Mr. Pauley talked to Mr. Davis about what he thought about his agreement and what he intended to do. [331] Do you want me to tell the conversation?

Mr. Clark: Yes, the substance of it.

A. The substance of it was Mr. Davis was not going to sign it.

The Court: Substance of what?

Mr. Clark: The conversation.

The Witness: Well, Mr. Davis was not going

(Testimony of George Bouchard.)

to sign it, and the conversation and substance was this: if this is what your Honor wants, or Mr. Clark wants. Mr. Pauley told Mr. Davis—is that the answer to your question, you want the conversation?

Q. (By Mr. Clark): Yes, the substance of it, if you can't remember what was said.

A. Mr. Pauley told Mr. Davis that he, Pauley, and Davis had been in a great many deals together, that they had always got along all right and had no difficulties and he didn't expect any difficulties would arise in this situation because of Mr. Davis' position as a limited partner. He told Mr. Davis that he intended to consult him on every matter of policy affecting Bay Rubber Company or the operation of the Pacific Tire and Rubber Company.

He also told Mr. Davis that he thought going into this deal with Mansfield would be a very profitable deal and that it would at least double the capacity of the Oakland plant.

That, in substance was the conversation, and Mr. Davis finally signed the agreement. [332]

Q. You were asked about Hayes as trustee holding an interest in Bay Rubber Co. Do you know for whom Hayes held and holds that interest? Four per cent interest, was it not? Do you know for whom?

A. I know now for whom.

Q. All right; for whom?

A. He holds one per cent for Mr. Clark Cameron and the other three of the four per cent is held for Mr. Pauley's children.

(Testimony of George Bouchard.)

Q. You were asked a great many questions about your examination of the minutes of the Pacific Rubber Company in September or October 1952, and you mentioned that you had had the minutes again in May 1955, of Pacific Rubber Company. When you examined them in September or October, whichever month it was, 1952, was there anything in the form of those minutes that seemed unusual to you or attracted your attention?

A. No, sir.

Q. When you examined those—where did you get them in May of 1955? From whom?

A. I got them from Mr. Hedges.

Q. In Los Angeles? A. Yes.

Q. When you examined the minutes in May 1955, was there anything in the form of them which attracted your attention at that time? [333]

A. There was.

Q. What was it?

A. It was in the minutes of May or December 28th, 1948, the original minutes.

Mr. Dinkelspiel: The only suggestion I can make in this matter, your Honor, is the witness has already testified that he could not testify as to any differences in the minute book between the time he saw the minutes in 1952 and the present time.

\* \* \* \* \*

Q. (By Mr. Clark): Go ahead and answer the question.

A. Yes, when I examined the minute book in May of this [334] year and read the minutes of

(Testimony of George Bouchard.)

the first meeting, I thought I noticed a very substantial difference between the typewriting on the first four pages and the typewriting on the last four pages.

Q. Did you do anything with respect to that?

A. I did.

Q. What? What did you do?

A. I took the book over to Mr. Clark Sellers.

Q. Who is Clark Sellers?

A. He is an examiner of questioned documents in the city of Los Angeles — and asked him to make an examination of this minute book. [335]

Mr. Clark: While Counsel is looking at that letter, if your Honor please——

Q. You testified on cross examination that you did not recollect more than a very few instances representing Mr. Davis as distinguished from Robbins Tire and Rubber Company. You were a member for a while of the Board of Directors of Pacific Tire and Rubber Company, were you not?

A. I was.

Q. And did you represent anybody while you were such member?

A. Yes, I was representing Mr. Davis as member of that board.

\* \* \* \* \*

The Court: Plaintiff's Exhibit 30 for identification.

(Whereupon letter dated November 19, 1954, [336] Bouchard to Pauley, was marked for identification Plaintiff's Exhibit No. 30.)

(Testimony of George Bouchard.)

Mr. Clark (Handing witness Exhibit 30): State whether or not that refreshes your recollection on the question whether you wrote any letters threatening litigation.

Mr. Dinkelspiel: That wasn't the question I asked him. O.K. I make no objection.

Mr. Clark: That is pretty close to it, I think.

A. Yes, I wrote that letter.

Mr. Clark: We offer it in evidence.

Mr. Dinkelspiel: I have no objection. It serves no purpose but I am not going to object.

The Court: All right, it will be admitted.

(Whereupon letter previously marked for identification was received in evidence as Plaintiff's Exhibit No. 30.)

### PLAINTIFF'S EXHIBIT No. 30

Bouchard & Little

Lawyers

Suite 900 Statler Center

900 Wilshire Boulevard

Los Angeles 17

November 19, 1954

Messrs. Edwin W. Pauley

Claude Cameron, General Partners

Bay Rubber Company

717 North Highland Avenue

Hollywood 38, California

Gentlemen:

Robbins Tire and Rubber Company has authorized me to commence suit against you and the part-

ners of Bay Rubber Company for breach of trust, accounting and wrongful conversion of assets belonging to Robbins as a stockholder of Pacific Rubber Company, which was dissolved and liquidated on or about January 10, 1951.

I refer particularly to an asset of Pacific Rubber Company represented by two agreements, one dated August 28, 1950, between Reconstruction Finance Corporation on the one hand and Pacific Rubber Company and Minnesota Mining and Manufacturing Company on the other hand, providing for the operation by Minnesota Mining and Manufacturing Company of a synthetic rubber plant located at Torrance, California, and one dated September 20, 1950, between Minnesota Mining and Manufacturing Company and Pacific Rubber Company. These assets had a value at date of liquidation of not less than \$1,000,000, of which Robbins Tire and Rubber Company owned 41.403% and John Condrey owned 58.597%.

The complaint in this matter will be filed at the end of five days from the date of this letter, unless within that time you indicate to me a desire to discuss a possible settlement of the issues involved.

Very truly yours,

/s/ George Bouchard.

GB:ba

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Recross Examination

Q. (By Mr. Dinkelspiel): I think your prior testimony was—if I don't misquote you—that you

(Testimony of George Bouchard.)

had not nor anyone to your knowledge on behalf of Mr. Davis or Robbins Tire and Rubber Company made any demand upon Pacific Rubber Company to set aside the proposed transfers of the synthetic rubber contracts to Bay Rubber Company.

A. That's right.

Q. You said you knew of no such demands?

A. That's right.

Q. And your testimony is the same now?

A. Yes. You mean prior to what time, Mr. Dinkelspiel?

Q. Well, you said prior to the filing of suit. Now, if you want to correct that, go ahead.

A. Well, I wrote that letter advising him a suit was in contemplation.

Q. Well, apart from that letter, and whatever the contents of that letter may disclose, there was no other demands of the kind I have asked you about? A. Well,—

Q. Is there something that refreshes your recollection since I asked you in the first instance?

A. I am not just sure what you mean by the scope of the question, Mr. Dinkelspiel. [338]

\* \* \* \* \*

Q. (By Mr. Dinkelspiel): Now, Mr. Bouchard, you mentioned something about representing Mr. Davis on the board of the Pacific Tire & Rubber Company. A. That's right.

Q. Now, is it not a fact that while you so represented Mr. Davis on the board you actually brought suit against the Pacific Tire & Rubber

(Testimony of George Bouchard.)

Company as attorney of record to foreclose certain properties the subject of promissory notes?

A. No. I resigned before that suit was filed.

Q. You resigned one week after the suit was filed, didn't you, Mr. Bouchard?

A. I don't think so, Mr. Dinkelspiel. It may have been a week later; I don't know. I am not certain of the date of resignation.

Q. And at that time, anyway, you were representing Mr. Davis on the board and you brought suit in behalf of Robbins Tire & Rubber against the same company?

A. I brought suit against the Pacific Tire to foreclose the mortgage.

Q. In behalf of Robbins Tire & Rubber Company?

A. Yes, Mr.—yes, my name appears as attorney of record.

Q. And I also understood you to testify in response to your counsel's questioning that the reason why a reservation was made in favor of directors or employees of [339] Minnesota Mining & Manufacturing Company in the setup of the interest of Bay Rubber Co. was that because Bay Rubber Co. was contemplating going into what kind of rubber business?      A. Mechanical.

Q. Mechanical rubber business.      A. Yes.

Q. Mechanical rubber business and they wanted to get some help from Minnesota Mining & Manufacturing Company?      A. Yes.

(Testimony of George Bouchard.)

Q. Who said that and who was present and when was that said?

A. Well, it was said on January 7, 1951 and it was said by Mr. Pauley in the presence of Mr. Davis and myself. Now, whether it was discussed by others I am not sure.

Q. Was anybody else present? Just you and Mr. Davis and Mr. Pauley?

A. I remember that very distinctly. Of course there were several people there in the office. Mr. Hedges was there, Mr. Bryan and Mr.—Mr. Bryan from Mansfield and—

Q. Whose office was this is?

A. Well, the one that I remember distinctly was in Mr. Pauley's office.

Q. I see. Now, this was signed about the 7th day of January 1951. A. It was that day.

Q. Now, at that time do you know whether Pacific Rubber Company [341] had any interest with Minnesota Mining & Manufacturing Company?

A. Yes, they did.

Q. As illustrated by agreement 5-A, agreement 5, and agreement 6; isn't that right?

A. Yes, sir. Correct.

Q. Do you know of any other business arrangements they had at that time, Pacific Rubber Company had at that time with Minnesota Mining & Manufacturing Company?

A. None to my knowledge.

Q. None to your knowledge?

A. No, sir.

(Testimony of George Bouchard.)

Q. Now, actually the partnership agreement was amended on December 28, 1951; isn't that correct?

A. Yes.

Q. And at that time Mr. Hayes acquired individually a four per cent interest in the partnership, in addition to that which he acquired as trustee?

A. Yes.

Q. And there was at that time no other business with Minnesota Mining & Manufacturing Company than these synthetic rubber contracts, was there?

A. Not to my knowledge, no.

Q. One other question, and I should have asked it on direct examination: Do you know for whom, if anybody, Mr. Davis was [341] acting as trustee when he signed the partnership agreement of the Rubber Company as trustee?      A. Yes.

Q. Who?      A. His children.

Q. You are sure of that?

A. Well, I am sure that's what he said.

Q. Did you read his deposition given in this case?

A. Yes, I know he did not create—

The Court: What?

Q. (By Mr. Dinkelspiel): Did he deny he was trustee for anybody?

A. Well, I didn't think he denied that. I think what he said, if I recall, was that he had not created a trust for the children.

Mr. Dinkelspiel: That's all, your Honor.

Mr. Clark: No questions.

No. 15336 ✓

IN THE

# United States Court of Appeals FOR THE NINTH CIRCUIT

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JOSEPH ORBY SMITH, JR.,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLEE'S BRIEF.

---

LAUGHLIN E. WATERS,  
*United States Attorney,*

LLOYD F. DUNN,  
*Assistant U. S. Attorney,*  
*Chief, Criminal Division.*

600 Federal Building,  
Los Angeles 12, California,  
*Attorneys for Appellee.*

**FILED**

DEC 3 1957

PAUL P. O'BRIEN, CLERK

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No. 15336

IN THE

# United States Court of Appeals FOR THE NINTH CIRCUIT

---

JOSEPH ORBY SMITH, JR.,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLEE'S BRIEF.

---

### 1956 APPEAL.

Note: For convenience this Brief is being divided into two sections, the first covering the 1956 appeal and the second covering the 1957 appeal.

#### I.

##### Jurisdiction and Statement of the Case.

The Government accepts the Jurisdictional Statement and Statement of the Case made by appellant insofar as the 1956 appeal is concerned.

II.

Argument.

Federal Sentence Could Not Be Concurrent With State Sentence Under Law.

We are indebted to appellant for quoting from Title 18, United States Code, Section 3568 (Appellant's Br. p. 12). It clearly indicates that a sentence shall not begin to run until the convicted person is received at, or is awaiting transportation to, the place designated for service of sentence with the Attorney General. Appellant then *speculates* that Title 18, United States Code, Section 4082, could have been the basis for service of a portion of the sentence in that the Attorney General has power to designate state prisons for service of sentence. Appellant *cites no evidence* that such was the case. There is none in the record because no such designation was made.

The appellant admits that he was in state custody, produced for prosecution by virtue of a writ, that he was returned to state custody after trial, and that he was then serving a state sentence of five years to life (Appellant's Br. p. 2). He was *taken into federal custody* on September 23, 1952 (Appellant's Br. p. 3). That is the date on which he commenced to serve his sentence in accordance with Section 3568.

The judge of the trial court must be taken to be cognizant of his own files, and thus to be aware that appellant was in the state custody, and present in court pursuant to the writ of habeas corpus *ad prosequendum*. This did not require him to state in his Judgment of conviction

that the sentence was *consecutive* to the existing state sentence since Section 3568 specifically provides, after indicating sentence is effective when custody of the convicted person is received, as follows:

“No sentence shall prescribe any other method of computing the term.”

*Vanover v. Cox* (8 Cir., 1943), 136 F. 2d 442, 443, cert. den. 320 U. S. 779;

*Hayden v. Warden* (9 Cir., 1941), 124 F. 2d 514, 515.

Appellant's arguments to the contrary (Appellant's Br. p. 12) are contrary to the federal law cited *supra*. The cases he cites for the proposition that the *state and federal* sentences must be deemed concurrent are inapposite, since they all involved two *federal* sentences. His criticism of the law is unacceptable since it clearly and definitely provides when the sentence commences to run. Nothing is left to “dangle indefinitely.”

Thus the 1956 Motion of appellant was properly denied by the trial court. On that Motion, as presented, the trial court was quite proper in opining, “There is simply nothing to correct” [1956 R. ca. 15].

*United States v. Raymond*, 218 F. 2d 952;

*United States v. Rivera*, 224 F. 2d 88, 89;

*Harrell v. Shuttleworth*, 200 F. 2d 491;

*Booth v. United States*, 209 F. 2d 183, 184;

*United States v. Tacoma*, 199 F. 2d 482, 483;

*Mahoney v. Johnston* (9 Cir., 1944), 144 F. 2d 663, cert. den. 324 U. S. 853.

1957 APPEAL.

I.

**Jurisdictional Statement.**

The jurisdiction of the District Court is founded upon Section 3231, Title 18, United States Code. The petition to vacate the original judgment was made by appellant under Section 2255, Title 28, United States Code. The jurisdiction of the Court of Appeals to entertain this matter may be found under the provisions of Section 1291, Title 28, United States Code, and Rules 37 and 39 of the Federal Rules of Criminal Procedure.

II.

**Supplemental Statement of Facts.**

On March 15, 1957, appellant filed his "Motion to Vacate Judgment of Conviction and Sentence" [Tr. 1957, p. 4]. In that document, under the heading "Relief Requested," appellant asked for all of the following:

1. Court Order for the appearance of one Ray E. Potts, attorney, Los Angeles, California.
2. *Subpoenas duces tecum* for medical and psychiatric records to the following:
  - a. Garfield Park Hospital, Chicago, Illinois (1942).
  - b. California Shipyards, Wilmington, California (1943).
  - c. San Quentin Prison, San Quentin, California (1943-7).
  - d. Folsom Prison, Represa, California (1943-7).
3. Subpoenaes to all of the following:
  - a. Dr. David Cohen, Veterans Administration Hospital, Coatesville, Pa.

- b. Dr. Joseph J. Peters, Philadelphia, Pa.
- c. Dr. Ray J. Simmonds, Sacramento, Calif.
- d. Dr. David G. Schmidt, San Quentin, California.
- e. Dr. Corbett H. Thigpen, Georgia.
- f. Dr. Hervey Cleckley, Georgia.
- g. Clinton T. Duffy, California Adult Authority, San Quentin, California.
- h. Cameron L. Lillie, Esq., Los Angeles, California.
- i. The F.B.I. agent who testified at trial (name not given).
- j. Edward C. Freutal, Esq., Los Angeles, California.

The Motion included an affidavit that appellant is an indigent person. It alleges in general terms that appellant was insane prior to and at the time of the commission of the offense and at time of trial, that his court-appointed attorney was inexperienced and thus that appellant was denied the effective assistance of counsel guaranteed him by the Constitution, that the trial court conspired with the United States Attorney to suppress evidence favorable to appellant, and that the United States Attorney knowingly used perjured testimony in violation of appellant's constitutional rights. No affidavits were attached to the Motion to support the appellant's claims as to proposed testimony of the above-identified witnesses. No detailed or factual offer of proof was made so that it could be determined whether the proffered evidence would be material to the requested hearing.

III.

**Argument.**

**A. Appellant's Showing Is Inadequate to Require Consideration.**

Appellant is an indigent person, or so claims to be. His 1957 Motion requests the issuance by the trial court of numerous subpoenas to persons at a great distance from the court. The purport of his efforts is to show that he was insane in 1947 when he committed the offense for which he is now incarcerated, and that his counsel was so inexperienced that he did not present the insanity defense at the trial. Parenthetically it should be noted that he was represented by other and different counsel on his motion for new trial and on his appeal, both of which were unsuccessful. He would put the Government to great expense on the basis of generalized assertions, and without any indication whatsoever that the testimony which he claims would be forthcoming is in fact available. While this is a civil action, in effect, it arises out of a criminal conviction affirmed on appeal by this Honorable Court. At the very least, before the Government should be put to the expense of assembling all of the requested witnesses, the burden should be placed on appellant to show that there is some merit to his assertions.

*Cf.* Rule 17(b), Federal Rules of Criminal Procedure, which requires an indigent defendant to make a showing by proper affidavit before a court is required to issue subpoenas on his behalf. He is also required under that rule to show the materiality of the testimony which he expects from said witnesses.

B. Appellant Smith Was Afforded That Degree of Representation by Counsel Guaranteed Him Under the Sixth Amendment.

Appellant Smith's complaints against the manner in which his case was handled by appointed counsel are peculiarly susceptible to the language of Judge Denman in *Latimer v. Cranor* (9 Cir., 1954), 214 F. 2d 926, 929:

"The application alleges that Latimer's attorney mishandled his case.

"This is a frequent contention of unsuccessful defendants. There are no allegations showing the attorney's conduct was so incompetent that it made the case a farce requiring the Court to intervene in his client's behalf. We find no denial of the efficient representation of the Constitution."

Generally, it may be said that the Constitution does not guarantee that appointed counsel shall measure up to the notions or standards of ability or competency of the accused. It is enough that the trial court appoints a qualified attorney to represent the defendant and that the attorney appears, advises and represents the defendant at all stages of the proceedings.

See:

*Losieau v. United States* (8 Cir., 1949), 177 F. 2d 919;

*Connolly v. Cox* (8 Cir.), 138 F. 2d 786;

*United States v. Regen* (7 Cir., 1948), 166 F. 2d 976;

*Moss v. Hunter* (10 Cir., 1948), 167 F. 2d 683;

*Soulia v. O'Brien* (1950), 94 Fed. Supp. 764, 770;

*Merritt v. Hunter* (10 Cir., 1948), 170 F. 2d 739;

*United States v. Wight* (2 Cir., 1949), 176 F. 2d 376, 379;

*Sheppard v. Hunter* (10 Cir., 1947), 163 F. 2d 872, 873;

*Williams v. United States* (4 Cir., 1954), 218 F. 2d 276, 279;

*Hayman v. United States* (9 Cir., 1953), 205 F. 2d 891, 894, and authority collected in Note 2, p. 895;

*United States ex rel. Thompson v. Die* (1952), 103 Fed. Supp. 776.

C. Appellant Smith May Not Use Proceedings Under 28 U. S. C. A., Section 2255, to Relitigate Issues Properly Raised by Appeal on the Merits.

From a reading of appellant's petition in this proceeding, it is apparent that he attempts to tardily raise, by means of petition under Section 2255 (*supra*), matters properly raised if at all upon his trial. Thus, for instance, he seeks now to have a determination made of his sanity and he desires an inquiry into the status of certain Government witnesses called at the trial. Both of such grounds are properly cognizable only at the trial, and should have been raised at that time. Of interest in this connection is the language of the Fourth Circuit in the recent case of *Banghart v. United States* (4 Cir., 1953), 208 F. 2d 902:

“A motion under 28 U. S. C. A. §2255 is proper only where the judgment under which a prisoner is confined is subject to collateral attack. It may not be used in lieu of appeal to review questions which were raised or *should have been raised upon the trial.*” (Emphasis added.)

See also:

*Hastings v. United States* (9 Cir., 1950), 184 F. 2d 939;

*Hurst v. United States* (10 Cir., 1949), 177 F. 2d 894;

*Hill v. United States* (6 Cir., 1955), 223 F. 2d 699;

*Davis v. United States* (7 Cir., 1954), 214 F. 2d 594;

*United States v. Rutkin* (3 Cir., 1954), 212 F. 2d 641;

*Goss v. United States* (6 Cir., 1949), 179 F. 2d 706;

*Storey v. United States* (8 Cir., 1949), 174 F. 2d 120.

D. The Instant Motion Is Insufficient to Bring the Question of Appellant's Sanity at the Time of the Trial Before This Honorable Court.

Appellant alleges that the instant Motion is brought as a writ of error *coram nobis*, a writ which was abolished by the 1948 Criminal Codification, but to some extent reactivated under the all writ's section by the decision of the Supreme Court in *United States v. Morgan*, 346 U. S. 502. It is perhaps more correct to say that in its attempted usage, the Motion here presents a petition in the nature of a writ of *coram vobis* rather than a writ of *coram nobis*. (*United States v. Right* (D. C. E. D. Ill., 1944), 56 Fed. Supp. 489, 492.) However, in any event, on the present showing of the petition the appellant is not entitled to a writ of *coram nobis*, inasmuch as that writ lies solely to view errors of fact extrinsic of the record which were not brought to the trial court's attention and that failure

being in no way imputable to the appellant. As stated in *In re Dyer* (1948), 193 F. 2d 69, 72:

“Whatever may be said about the inception of the writ, the recognized present purpose is to correct an error of fact which was unrecognized prior to the final disposition of the proceeding. It is not intended as a means of revising findings based on known facts or facts that should have been known by the exercise of ordinary and reasonable diligence.”

See also:

*State v. Woodward* (1945), 160 P. 2d 432;

*People v. Butterfield* (1940), 99 P. 2d 310;

*City of St. Louis v. Franklin Bank, et al.*, 173 S. W. 2d 837, 847;

*People v. Mooney* (1918), 174 Pac. 325,

cited with approval by the United States Court of Appeals for the Ninth Circuit in

*Audette v. United States* (9 Cir., 1938), 99 F. 2d 113.

Additionally, for background material, see cases collected at page 63 in the Syllabus in the case of *United States v. Myer*, 235 U. S. 55.

**E. Appellant Must Make Facts Showing to Be Entitled to Hearing on Allegations as to the Knowing Use of Perjured Testimony.**

“A criminal conviction procured by the use of testimony known by the prosecuting authorities to be perjured, and knowingly used by them in order to procure a conviction, is of course not in compliance with due process of law, and is violative of a defendant's constitutional rights. (Cases cited.) But a defendant

has the *burden of making a showing*, not only that material perjured testimony was used to convict him, but that it was knowingly and intentionally used by the prosecuting authorities in order to do so.

“But trivial conflicts in testimony . . . do not constitute perjury.

“In order to obtain a hearing under Section 2255, a petitioner must make a *more substantial showing* than merely charging perjury and making the *unsupported claim* that perjured testimony was knowingly used by the prosecuting authorities.

“Appellant’s petition is replete with conclusions that many of the witnesses at the trial committed perjury, but he fails to aver the existence of facts to support such conclusions. His unsupported broad charges will not suffice. In *United States v. Sturm* (7 Cir.), 180 F. 2d 413, 414, we said, ‘Just as a petition for a writ of habeas corpus . . . must set forth the facts as distinguished from mere conclusions . . . (citing cases) so, it would seem clear, must such a motion as that authorized by Section 2255 . . .’”  
(Emphasis added.)

*United States v. Spadafora* (7 Cir., 1952), 200 F. 2d 140, 142, 143.

Likewise, no such showing was made in the instant case by appellant. In addition he had a trial, was represented by counsel throughout, who had the opportunity to cross-examine the witnesses, and he took an unsuccessful appeal. His motion for new trial included a claim of perjured testimony as to a witness Patrick, but that motion was rejected. The witness Jobe, contrary to appellant’s contentions, was not a key or principal witness in the prosecution’s case. An examination of the record

reveals that his testimony went only to corroborate more damaging evidence of defendant's participation.

Appellant has not sustained the heavy burden which is placed on him in a collateral attack on the affirmed judgment of conviction. (*Bishop v. United States* (D. C. Cir., 1955), 223 F. 2d 582, cert. gtd. other grounds, 350 U. S. 961.) Hence, appellant is not in the position to claim that he should have had a hearing on the allegation of knowing use of perjured testimony.

**F. Insanity at the Time of the Commission of a Crime Is a Defense Which Should Not Be Presented Upon Motion Under Section 2255.**

The issue of insanity as a defense is presentable upon the trial and appealable if error has been made in respect to it. A motion to vacate under Section 2255 cannot be used as a substitute for an appeal.

*Smith v. United States* (D. C. Cir., 1950), 187 F. 2d 192, cert. den. 341 U. S. 927.

Thus, an alleged insanity at the time of the commission of the crime cannot be used as a basis for a motion under Section 2255.

See:

*Rolfe v. Lloyd* (9 Cir., 1939), 102 F. 2d 606;

*Hall v. Johnston* (9 Cir., 1936), 86 F. 2d 820;

*Byrd v. Pescor* (8 Cir., 1947), 163 F. 2d 775, cert. den. (1948), 333 U. S. 846.

**G. Insanity at the Time of Trial Under Section 2255.**

Here the question is whether at the time of trial appellant was mentally competent to understand the proceedings against him and properly to assist in his own defense.

There appears to be a division among the Circuits upon whether the question can be raised by a motion under Section 2255.

*Forthoffer v. Swope* (9 Cir., 1939), 103 F. 2d 707;

*Hahn v. United States* (10 Cir., 1949), 178 F. 2d 11;

*McMahon v. Hunter* (10 Cir., 1945), 150 F. 2d 498, cert. den. 326 U. S. 783;

*Ashley v. Pescor* (8 Cir., 1945), 147 F. 2d 318;

*McIntosh v. Pescor* (6 Cir., 1949), 175 F. 2d 95.

But see: *Bishop v. United States*, 350 U. S. 961, in which the Supreme Court of the United States granted certiorari, and remanded the case to the District Court for sanity hearing without other comment.

In *Forthoffer, supra*, this Circuit emphasized, at page 710, that the burden is on the petitioner to offer facts which would justify a court of the United States in setting aside a judgment of another court of the United States, a thing not lightly to be undertaken. There the petitioner had waived trial and pled guilty.

By analogy, where, as here, the court is being asked to set aside its own judgment on alleged grounds *dehors* the record, the burden of proof must be on the moving party *to offer facts*, not mere *conclusions*, which would warrant the trial court in setting a full scale hearing; Such was not done in this case. Furthermore, the trial judge saw the defendant in court and while he was on the stand as a witness, and therefore had an opportunity to judge for himself whether or not the defendant was sane at the time of trial. No presentation of the alleged insanity at time of trial was made either by defense counsel at the trial, or at any stage of the motion for new trial

or appeal which followed. Therefore, all we have are the allegations of the appellant at this time that he was then insane.

“The District Judge would not have been warranted in conducting a hearing to determine whether the judgment should be set aside on any such vague allegations, particularly in a case where the petitioner had been represented on the trial by counsel and the proceedings against him had been reviewed on a motion for new trial and on appeal to this court.”

*Sanders v. United States* (4 Cir., 1950), 183 F. 2d 748, 749, cert. den. 340 U. S. 921.

It is incumbent upon appellant to make some showing which would overcome the presumption of regularity which attends the judgment of a court when a collateral attack is made on it.

*Forthoffer v. Swope* (9 Cir., 1939), 103 F. 2d 707, 711;

*McKinney v. United States* (D. C. Cir., 1953), 208 F. 2d 844, 847;

*Johnson v. Zerbst* (1938), 304 U. S. 458, 468.

#### H. The Findings of Fact and Conclusions of Law Are Supported by Evidence.

The findings [1957 R. 20] show that they were based on the records and files of the cause. Appellant admits that he was convicted after jury trial (Appellant's Br. p. 2); that, represented by different counsel, he did appeal (173 F. 2d 181, 9 Cir., 1949); that this Honorable Court affirmed the conviction (Appellant's Br. p. 3); and that one of the grounds of appeal was insufficiency of the evidence (Appellant's Br. p. 3). Inherent in this situation is that a reporter's transcript was prepared and filed. This,

and the Clerk's Record of Proceedings, constitute the records and files upon which the Court properly relied in determining the issues raised by appellant.

Whether or not appellant was ably represented at the trial by counsel is a matter more easily determined by observing actions than by hindsight in examining a record. Therefore the trial judge was eminently qualified to make a finding as to the quality of the representation given defendant at the trial. He had a record from which to refresh his memory as to the events of the trial.

Also, as indicated heretofore in this brief, the very assertions of appellant as to an alleged conspiracy of the United States Attorney to convict defendant by the use of perjured testimony and as to his mental incompetency at the time of trial were too broad to require the District Court to entertain a hearing in respect to these items. There was no evidence before the court on such matters, and therefore the findings of the court as to the lack of such evidence were proper.

Furthermore, since the defendant was present in the court during all stages of the trial, it is clear that the court had jurisdiction of his person at the time of trial.

The conclusions of law properly follow from the findings of fact which precede them, and are supported by said findings.

The appellant has not pointed out in any respect where the findings of fact are in error except for the allegation that there was no evidence to support them. He then states they are clearly erroneous (Appellant's Br. p. 10). This is not true because the files on record, including the transcript of the trial, were before the court. The rules of

this circuit require the appellant to specify wherein the findings of fact are in error. Rule 18(2)(d) provides:

“In all cases when findings are specified as error, the specifications shall state as particularly as may be wherein the findings of fact and conclusions of law are alleged to be erroneous.”

The objections offered herein are inadequate to comply with this rule, and for that reason are not further considered.

### Conclusion.

1. The 1956 appeal is without merit because the federal sentence could not be concurrent with the state sentence under existing law.
2. The 1957 appeal should be denied because the appellant has not made any substantial showing to base his unsupported claims regarding the knowing use of perjured testimony, his insanity at the time of the commission of the crime and at the time of the trial, nor as to the alleged lack of the effective assistance of counsel.
3. The findings of fact and conclusions of law made by the trial court upon the hearing of the Motion under Section 2255 in 1957 are adequately supported by the records and files in this cause. Wherefore, appellee respectfully prays that the appeals be denied.

LAUGHLIN E. WATERS,  
*United States Attorney,*

LLOYD F. DUNN,  
*Assistant U. S. Attorney,*  
*Chief, Criminal Division.*

*Attorneys for Appellee.*

No. 15,350 ✓

IN THE  
**United States Court of Appeals  
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CAMMARANO, his wife,  
vs.  
UNITED STATES OF AMERICA,

*Appellants,*  
*Appellee.*

---

APPELLANTS' OPENING BRIEF.

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ATHEARN, CHANDLER & HOFFMAN,  
WALTER HOFFMAN,  
CLARK W. MASER,  
Seventh Floor, Balboa Building,  
San Francisco 5, California,  
JONES & GREY,  
A. R. KEHOE,  
HARGRAVE A. GARRISON,  
610 Colman Building, Seattle, Washington,  
*Attorneys for Appellants.*

FILED

MAR 11 1957

PAUL P. O'BRIEN, CLERK



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No. 15,350

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**APPELLANTS' OPENING BRIEF.**

---

**STATEMENT OF JURISDICTION.**

Suit was brought by plaintiff taxpayers in the District Court for the recovery of income taxes, after timely claim for refund was filed with the Collector of Internal Revenue at Tacoma, Washington (TR. 3-10, 11-12, 44).

This is an appeal from a judgment rendered in said action against plaintiffs, appellants herein, and in favor of the United States, defendant and appellee. The judgment was entered on July 30, 1955 by the U. S. District Court for the Western District of Washington, Southern Division, sitting without a jury (TR. 49, 50).

The jurisdiction of the District Court was based upon 28 U.S.C., Sec. 1346(a)(1).

The jurisdiction of this Court on appeal is based on 28 U.S.C., Secs. 1291, 1294.

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#### **STATEMENT OF THE CASE.**

The subject of this appeal is whether a Treasury Regulation (disallowing as a deduction certain types of business expenses) may be validly applied under Sec. 23(a) I.R.C. (allowing the deduction of all "ordinary and necessary" business expenses): to expenditures incurred by taxpayers for publicity in defeating an Initiative Measure which would have deprived taxpayers of their existing business.

Plaintiffs, Appellants herein, are husband and wife who owned a one-fourth interest in a partnership engaged in the wholesale distribution of beer in the State of Washington (TR. 45).

At the Washington State General Election of November 2, 1948 an Initiative Measure was submitted to a vote of the People. The Measure if enacted, would have placed the retail sale of beer exclusively in the hands of state-owned and operated retail liquor stores. The proposed Initiative had been previously submitted to the Legislature. However, the Legislature failed to act on the Measure during the 1947 session, whereupon the Initiative was submitted to the People in 1948. The Legislature was not in session during the year 1948 (TR. 22, 23, 45, 46).

During the year 1948 and prior to said election, the partnership of which Appellants were members, made payments totaling \$3545.15 to a fund for the purpose of defeating the Initiative. Members of the Washington Beer Wholesalers Association, of which plaintiffs were members, made contributions to the fund as well as non members. The payments were made to the fund on the basis of the volume of business of each wholesaler (TR. 45, 46).

The fund was expended to combat the Initiative in a state-wide publicity campaign addressed solely to the public in the form of newspaper advertising, radio broadcasting, street car and billboard advertisements, and direct mail literature. The Initiative was defeated (TR. 46, 115).

Uncontradicted testimony was introduced that if the Initiative Measure had been enacted at least ninety per cent of the beer wholesalers of the State of Washington would have been put out of business; some of the wholesalers, acting as representatives of beer manufacturers, might thereafter have been able to do some business with the State. Since the plaintiffs were wholesalers and their customers were retailers, plaintiffs would have been deprived of all their existing customers had the Initiative been enacted (TR. 76, 77).

The Initiative was self-operative and no further action by the Legislature was necessary. However under the laws of the State of Washington, enactment of an Initiative Measure does not have the effect of a constitutional amendment. Any enacted Initiative

Measure may be subsequently amended by the Legislature by a two-third's vote within two years after enactment of the Initiative and by a majority vote thereafter (TR. 93-96).

Appellants, in filing their joint federal income tax return for the year 1948, deducted as a business expense their proportionate part of the expenditures so made by the partnership in the campaign against the Initiative (TR. 12, 16).

Sec. 23(a)(1)(A) of the Internal Revenue Code of 1939 as amended, provided that in the computation of net taxable income, a taxpayer shall have the right to deduct from gross income "All the ordinary and necessary expenses paid . . . in carrying on any trade or business . . ."

Treasury Regulations 111, Sec. 29.23(o)-1 relating to individuals provided: "Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda . . . are not deductible from gross income."

The Commissioner of Internal Revenue disallowed the expenditures as a deduction on the ground that a Regulation pertaining to corporations but containing the same language as the Regulation pertaining to individuals, previously quoted, barred the deduction of said expenditures (TR. 6, 21).

After payment under protest of the additional income tax assessed, and failure of the Commissioner to act upon Appellants' timely claim for refund, Appellants brought this action in the District Court for

recovery of the additional income tax so paid under protest (TR. 44).

The District Court affirmed the ruling of the Commissioner, on the ground that Reg. 111, Sec. 29.23 (o)-1 pertaining to individuals (previously quoted) barred said expenditures as a deduction from gross business income (TR. 47, 48).

This appeal involves the question whether: said application of the Regulation is unauthorized and hence invalid because in contravention of the intent of Congress expressed in Sec. 23(a)(1)(A) that all "ordinary and necessary expenses" paid in carrying on any business are deductible.

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#### **SPECIFICATION OF ERRORS RELIED UPON.**

(1) The District Court erred in its finding of fact: "The payment made to the Trust Fund by Cammarano Brothers was for propaganda and was to defeat legislation, and was therefore neither ordinary nor necessary to the usual course of the partnership business." (Finding of Fact No. 11; TR. 47).

All of the expenditures were incurred in making a public appeal to the People in opposition to a measure voted upon by the People. The expenditures were made for the purpose of preserving the continuance of taxpayers' existing business: had the Initiative been enacted the partnership would have been deprived of all of its existing customers. The Supreme Court in a series of cases has held that such ex-

penditures are "ordinary and necessary expenses . . . incurred . . . in carrying on any trade or business . . ." within the express language and meaning of Sec. 23(a)(1)(A).

(2) The District Court erred in its conclusion of law: "But it is perfectly clear that the payment to the Trust Fund was entirely for propaganda, and aimed at the defeat of legislation. For both of these reasons, and without in any way condemning the stand taken in the campaign, the payment is not deductible under that Section, according to long-standing Treasury Regulations (TR. 111, Sec. 29.23(o)-1) and a host of judicial decisions." (Conclusion of Law No. 2; the reference to "that Section", as appears from the previous part of the conclusion of law, is to Sec. 23(a)(1)(A); TR. 47, 48).

Treas. Reg. 111, Sec. 29.23(o)-1, by reason of a series of Supreme Court decisions, cannot be validly applied to bar such expenditures as a deduction under Sec. 23(a)(1)(A) on the grounds of either public policy or as a justifiable exercise of the rulemaking authority of the Commissioner.

(3) The District Court erred in its conclusion of law: "Plaintiffs make much of the fact that the instant publicity campaign was aimed at the people generally rather than the legislature, but no such distinction is recognized by the cited cases nor does it commend itself to reason. Certainly publicity can be directed at legislators both directly and indirectly. But more important for purposes of this case, the measure at which the instant campaign was aimed

was clearly legislation, albeit subject to enactment by the people generally rather than members of a Legislature." (Conclusion of Law No. 2; TR. 48).

The Court erred in the foregoing conclusion of law for the same reasons herein stated with respect to the previous conclusion of law.

(4) The District Court erred in its conclusion of law: "Plaintiffs are not entitled to a refund of their 1948 income taxes, and their complaint must be dismissed. Judgment may be entered accordingly". (Conclusion of Law No. 3; TR. 48).

(5) The District Court erred in failing to find and conclude that the Regulation referred to cannot be validly applied to bar said expenditures as a deduction and in failing to find that said expenditures were "ordinary and necessary" expenditures incurred in carrying on a business within the meaning of Sec. 23(a)(1)(A) and therefore were deductible in the computation of taxpayers' net taxable income.

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#### SUMMARY OF ARGUMENT.

(1) The Regulation cannot be validly applied to bar the instant expenditures as a deduction on the ground that the application of the Regulation falls within the authorized rule-making power of the Commissioner.

The function of the Commissioner is to administer the Revenue Code and to carry out within limits of a reasonable interpretation, the will of Congress expressed in the Code.

The Commissioner cannot validly apply a Regulation to the facts of a case where to do so contravenes the express language of a section of the Code even though the Regulation as applied to other facts may be valid.

The Supreme Court has held that expenditures made to preserve the continuance of an existing business are ordinary and necessary within the express language and meaning of Sec. 23(a)(1)(A), beyond question and as a matter of law.

(2) The Regulation cannot be validly applied to bar the instant expenditures as a deduction on the ground that Congress by re-enacting Sec. 23(a)(1)(A) has therefore impliedly adopted the instant application of the Regulation as a part of said Section.

The Regulation has been captioned and indexed by the Commissioner under sections of the Internal Revenue Code entitled and dealing with "Charitable and Other Contributions" (first under Sec. 23(n) and then under Sec. 23(o))—which Code sections are entirely different in concept and purpose from Sec. 23(a)(1)(A).

The Commissioner by his continued published acquiescence in a decision by the Tax Court, hereafter considered, has himself interpreted the Regulation as not applicable to expenditures incurred in connection with measures voted upon by the People.

To impute to Congress an implied adoption of an application of the Regulation contrary to the Commissioner's own captioning, indexing and interpreta-

tion of the Regulation, is therefore unreasonable and fictional.

In any event the Supreme Court has held that the theory of statutory re-enactment can never be invoked where an application of a Regulation contravenes the express language and meaning of a Code section. Application of the Regulation in the instant case directly contravenes Sec. 23(a) permitting the deduction of ordinary and necessary business expenses because the Supreme Court has held in a series of cases that expenditures incurred to preserve the continuance of an existing business fall within said Section beyond question.

(3) The Regulation cannot be validly applied to bar the instant expenditures as a deduction on the ground of public policy.

Congress in the enactment of the Revenue Code has not conferred any express authority upon the Commissioner to bar a deduction on the ground of public policy.

The Supreme Court has therefore held that public policy can be invoked by the Commissioner as a bar to the deduction of expenditures under Sec. 23 (a)(1)(A) only where the expenditures violate clearly declared public policy: sharply defined national or state policies proscribing particular types of conduct.

Expenditures incurred in making a direct and open appeal to the People in opposition to an Initiative Measure vitally affecting an individual's business, are

not in any conceivable way in violation of any public policy. On the contrary such expenditures incurred in the exercise of an individual's fundamental right of free speech are clearly in the public interest and in furtherance of public policy.

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Thus the Regulation cannot be validly applied to bar the expenditures here incurred, on the basis of any of the three only justifiable grounds for any possible valid application of the Regulation.

Each of the three foregoing premises upon which the conclusion is based that the lower court erred, is supported by decisions of the Supreme Court.

The final adjudications in pertinent decisions by the lower courts, hereafter also considered, are not necessarily in conflict with the conclusion that the Regulation cannot be validly applied to bar the expenditures here in question. To the extent, however, that any statements appear in such decisions to the contrary, they must yield to the superior authority of the Supreme Court decisions.

Preliminary to a consideration of the authorities in support of each of the foregoing premises, it is important to first consider the scope and purpose of the pertinent sections of the Revenue Code and the Regulation.

**ARGUMENT.****I.****PROVISIONS OF THE REVENUE CODE AND THE REGULATION.**

The expenditures here in question, incurred in 1948, were subject to the provisions of the Revenue Code of 1939 as amended. The same sections of the Code have been embodied and renumbered in the existing Revenue Code of 1954, as hereafter indicated.

(1) *Section 23(a)(1)(A) of the Revenue Code of 1939* as amended (now Sec. 162(a)) relating to the deduction from gross income of ordinary and necessary expenses incurred in carrying on any trade or business provides:

“§23. *Deductions from gross income.* In computing net income there shall be allowed as deductions:

(a) *Expenses.*

(1) *Trade or business expenses.*

(A) *In general.* All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . .”

Plaintiff taxpayers claimed and now claim a deduction of the expenditures under the foregoing section of the Code.

The Commissioner in the Court below took the position that the provisions of the Regulation relating to lobbying, the promotion or defeat of legislation were referable to said section of the Revenue Code. The Court in its Conclusions of Law likewise referred

said provisions of the Regulation to said section of the Code (TR. 15, 16, 47, 48).

(2) *Section 23(o) of the Revenue Code of 1939* as amended (now Sec. 170) relating to deductions from gross income of contributions by individuals to an organization operated exclusively for religious, charitable, scientific, literary or educational purposes without any part of net earnings inuring to the benefit of any shareholder or individual provides:

“(o) *Charitable and other contributions.*

In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes;

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation. For disallowance of certain charitable, etc., deductions otherwise allowable under this paragraph, see sections 3813 and 162

(g)(2);” (italics ours; Sec. 23(q) relating to corporations contains a similar provision).

Plaintiff taxpayers do not claim a deduction of the expenditures under the foregoing section.

Neither the Commissioner in the Court below nor the Court in its Conclusions of Law, took the position that the provisions of the Regulation relating to lobbying, the promotion or defeat of legislation were referable to said section of the Revenue Code.

However, the following history of Sec. 23(o) has been set forth for the purpose of showing that the concept, purpose and considerations involved in the enactment of Sec. 23(o) by Congress are entirely different from Sec. 23(a).

Section 23(o), previously set forth, expressly provides that the deduction shall only be allowed if no substantial part of the activities of the charitable, religious or educational, non profit organization: “. . . is carrying on propaganda, or otherwise attempting to influence legislation.” On the other hand Sec. 23(a)(1)(A) significantly contains no similar words of limitation.

The expenditures here in question, incurred in preserving the continuance of taxpayers’ existing business, clearly fall within the scope and application of Sec. 23(a)(1)(A) and do not fall within the scope and application of Sec. 23(o) relating to “Charitable and other contributions.”

Deductions allowable under Sec. 23(o) are of an entirely different type and character than deductions allowable under Sec. 23(a)(1)(A).

Under Sec. 23(a)(1)(A) an expenditure in order to be deductible: (1) must be incurred in carrying on a trade or business and additionally (2) must be ordinary and necessary.

Under Sec. 23(o) a deduction is allowable without any requirement that the contribution be an ordinary and necessary expense incurred in the course of operating a business. A contribution falls within that section simply if the contribution is made to (1) a charitable, religious, educational or similar organization, non profit in character (2) no substantial part of the activity of which is carrying on propaganda or attempting to influence legislation. This is the section of the Revenue Code, of course, under which Community Chest and other charitable and religious contributions are allowable as a deduction to an individual regardless of whether the individual is engaged in business.

The proviso that no substantial part of the activities of such charitable, religious or educational organization shall be the carrying on of propaganda or attempting to influence legislation, was first enacted in 1934 as a part of Sec. 23(o). Prior to the Revenue Act of 1934, the Code sections which were the predecessors of Sec. 23(o) allowed deductions to charitable, religious, educational and similar organizations without the qualification of the proviso.

Sec. 23(o) and its predecessors pertained only to individuals. Corporations were not allowed to deduct contributions to charitable, religious or educational organizations under the Revenue Act of 1934 or under any prior Act. Sec. 23(r) of the Revenue Act of 1935 for the first time allowed corporations to deduct such contributions (Sec. 23(r) became Sec. 23(q) in the Revenue Act of 1936). The section so enacted in 1935 embodied substantially the same language as Sec. 23(o) relating to individuals and included the proviso that no substantial part of the activities of such charitable, religious or educational organization shall be the carrying on of propaganda or attempting to influence legislation.

Sec. 23(o) relating to individuals and Sec. 23(q) relating to corporations are now embodied in a single section of the Code numbered 170 in the Revenue Code of 1954.

The Congressional Record and reports of Committee hearings show that Congress in 1934, when the proviso was first enacted, was acutely aware of the existence of organizations whose primary purpose was the dissemination of propaganda under the guise of charitable, religious and educational organizations (Vol. 78 Cong. Rec.; Part 6, p. 5861, April 2, 1934; p. 5959, April 4, 1934: Part 7, pp. 7816, 7821, 7831, May 1, 1934). The Record shows that there was no discussion whatsoever or mention made of Sec. 23(a) (1)(A) on the floor of Congress or in the Committee hearings or reports. Congress was simply dealing with the question whether a charitable, religious, edu-

cational or similar organization should no longer be regarded as such for tax purposes, where a substantial part of the activities of any such organization is for the purpose of carrying on propaganda and influencing legislation.

Thus the history and context of Sec. 23(o) shows that it deals with a type and character of expenditure entirely different than Sec. 23(a)(1)(A). Sec. 23(o) relating to charitable and similar contributions concerns itself only: with the nature of the activities of the recipient of the contribution and allows such contributions as a deduction regardless of whether the donor is engaged in business or whether the contributions are ordinary and necessary to any business.

In contrast, Sec. 23(a)(1)(A) relating to expenses incurred in carrying on a business, concerns itself not with the activities of the recipient but only with the activities of the person making the expenditure and the nature of the business expenditure so made. The two sections deal with entirely different aspects of allowable income tax deductions. It is clearly manifest, therefore, that the insertion by Congress of the proviso as a part of Sec. 23(o) in 1934, involved matters of policy and considerations not in any way pertinent or related to Sec. 23(a)(1)(A).

In any event it is sufficient to observe that Congress in 1934 expressly included the proviso in Sec. 23(o) and expressly excluded the proviso from the language of Sec. 23(a). In subsequent re-enactments of the Revenue Code including the Revenue Act of 1954, Congress made no change whatsoever in the

express inclusion of the proviso in the one section and its exclusion from the other section.

(3) *Treasury Regulations 111* (now *Regulations 118*) in force during the year 1948 when the expenditures here in question were incurred and upon which the lower Court based its decision, provides:

“Sec. 29.23(o)-1. Contributions or gifts by individuals.—

A deduction is allowable under section 23(o) only with respect to contributions or gifts which are actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books and records. A deduction is not allowable, however, for the actual payment of a contribution or gift if the amount of such payment already has been deducted on the accrual basis in computing net income for any taxable year beginning before January 1, 1938. A contribution or gift to an organization described in section 23(o) is deductible even though some portion of the funds of such organization is or may be used in foreign countries for charitable and educational purposes. This section does not apply to contributions or gifts by estates and trusts (see section 162). For computation of deductions for charitable contributions where the taxpayer also has an allowable deduction for medical expenses, see section 29.23(x)-1.

\* \* \* \* \*

In the case of husband and wife making a joint return, the deduction for contributions or gifts is the aggregate of such contributions or gifts made by the spouses, and is limited to 15 percent of the aggregate adjusted gross income of the

spouses or, for taxable years beginning prior to January 1, 1944, 15 percent of the aggregate net income of the spouses computed without the benefit of the deduction for contributions.

A donation made by an individual to an organization other than one referred to in section 23(o) which bears a direct relationship to his business and is made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute an allowable deduction as business expense.

*Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.*

\* \* \* \* \*

... Claims for deductions under section 23(o) must be substantiated, when required by the Commissioner, by a statement from the organization to which the contribution or gift was made showing whether the organization is a domestic organization, the name and address of the contributor or donor, the amount of the contribution or gift and the date of the actual payment thereof, and by such other information as the Commissioner may deem necessary." (italics ours) (see Appendix for full text of the Regulation.)

It should be noted first that the Regulation in its preface is indexed by the Treasury "23(o)-1". This index refers to Sec. 23(o) of the Revenue Code relating to individuals, which section of the Code in turn is captioned "Charitable and other contributions".

In considering the subsequent topics of this brief it is important to trace in some detail the history of the Regulation and also of an additional Regulation pertaining to corporations, even though such historical recital may be somewhat tedious. The historical indexing of the Regulation by the Treasury under an intended applicable section of the Revenue Code and likewise the title given the Regulation by the Treasury, are important considerations in determining whether it may be contended that Congress, in re-enacting Sec. 23(a) of the Revenue Code, impliedly adopted the Regulation as a part of said Section.

The italicized provision with respect to lobbying and the promotion or defeat of legislation was first inserted in the Regulation in 1938. The Regulation was then a portion of Regulations 101, and was indexed and captioned "Art. 23(o)-1. Contributions or gifts by individuals."

The Regulation at all times thereafter continued to be so indexed and captioned by the Treasury under the Section of the Revenue Code, separately and distinctly relating to charitable, religious and educational contributions by individuals as distinguished from Sec. 23(a) of the Revenue Code relating to ordinary and necessary business expenses.

In *Textile Mills Sec. Corp. v. Commissioner*, 314 U.S. 326 (1941) the Supreme Court considered a Regulation pertaining to corporations, which also contained a provision relating to lobbying and the promotion or defeat of legislation. In view of the importance of the decision in the *Textile* case, which will be considered

hereafter in detail, the history of the Regulation pertaining to corporations must also be considered.

The Regulation pertaining to corporations was first issued in 1918 as Reg. 33, Art. 143. It read as follows:

“Art. 143. Lobbying expenses.—Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, and contributions for campaign expenses are held not to be an ordinary and necessary expense in the operation and maintenance of the business of a corporation, and are therefore not deductible from gross income in arriving at the net income upon which the income tax is computed.”

In 1919 the context of the Regulation was enlarged by including provisions: that donations to charitable and educational institutions were only deductible by a corporation when directly related to the business of the corporation, such as donations for the benefit of the employees or donations representing consideration for benefits flowing directly to the corporation. At that time and until 1935 corporations, unlike individuals, were not entitled to deduct charitable and educational contributions. The Regulation was thereafter successively captioned “Donations” and “Donations by corporations”.

In 1935 corporations for the first time were given the right to deduct charitable, religious and educational contributions by enactment of Sec. 23(r) of the Revenue Code, immediately succeeded in 1936 by Sec. 23(q), which latter Code section was titled “Charitable and Other Contributions by Corporations”. The Reg-

ulation in 1936 was indexed under "Art. 23(q)-1" of Regulations 94, the reference to "23(q)" being to Sec. 23(q) of the Code<sup>*and was*</sup> titled "Contributions or gifts by corporations". The indexing and captioning ever since that time has remained the same.

Thus the Regulations containing the provision with respect to lobbying and promotion or defeat of legislation, both in the case of individuals and in the case of corporations, have been indexed and captioned by the Treasury with reference to sections of the Code relating to charitable and other similar contributions, and not with reference to Sec. 23(a) relating to ordinary and necessary business expenses.

As previously pointed out, the Commissioner in the Court below took the position that the provisions of the Regulation relating to lobbying, the promotion or defeat of legislation were referable to Sec. 23(a)—not Sec. 23(o) (TR 15, 16).

The lower Court likewise in its Conclusions of Law held that said provisions of the Regulation were referable to Section 23(a)—not Sec. 23(o).

In the topics considered in this brief relating to the rule-making authority of the Commissioner [but not with respect to the topic of statutory re-enactment] and in order to meet the issue raised by the Commissioner and the Court below, we have assumed *arguendo*, that the Regulation relating to individuals may be referred to Sec. 23(a).

(4) *Section 3791 of the Revenue Code of 1939* as amended (now Sec. 7805) relating to the authority of the Commissioner to issue regulations, provides:

"§3791. *Rules and regulations.*

(a) Authorization.

(1) In general. Except as provided in section 1928(a), Cotton Futures, Section 2599, Marihuana, section 2559, Narcotics, section 2176 Liquor, and section 1805, Silver, the Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title."

In addition to the foregoing general authorization, Congress in numerous instances has re-incorporated the same provision in particular Code Sections dealing with specific subjects. Sec. 23(a)(1)(A) does not contain any such additional specific authorization.

In the light of the foregoing background of the context and history of the pertinent sections of the Revenue Code and the Regulation we will now consider the specific question whether: the Commissioner can validly apply the Regulation to bar as a deduction the expenditures here incurred for the purpose of preserving the continuance of an existing business—in the face of the Congressional mandate contained in Sec. 23(a)(1)(A) expressly allowing a taxpayer the right to deduct "all ordinary and necessary expenses . . . incurred . . . in carrying on any trade or business . . .".

## II.

**THE REGULATION CANNOT BE VALIDLY APPLIED TO BAR THE EXPENDITURES AS A DEDUCTION ON THE GROUND THAT ITS APPLICATION FALLS WITHIN THE AUTHORIZED RULE-MAKING AUTHORITY OF THE COMMISSIONER.**

Before considering the series of cases wherein the Supreme Court has held that expenditures incurred for the purpose of preserving the continuance of an existing business are "ordinary and necessary expenses" within the meaning of Sec. 23(a) beyond question, the rule-making authority of the Commissioner should first be considered.

- (1) The Supreme Court has held that the function of the Commissioner is to administer the Revenue Code and to carry out within the limits of a reasonable interpretation the will of Congress expressed in the Code and that the application of any Regulation contrary to such will is invalid.

In *Manhattan General Equipment Company v. Commissioner*, 297 U.S. 129 (1936), the issue was whether a regulation relating to the cost basis of stock upon reorganization was authorized and valid under a pertinent section of the Revenue Code. In holding the Regulation unauthorized and therefore invalid, the court said:

"The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Lynch v. Tilden Produce Co.* 265 U.S.

315, 320-322, 68 L. ed. 1034-1036, 44 S. Ct. 488; Miller v. United States, 294 U.S. 435, 439, 440, 79 L. ed. 977, 980, 981, 55 S. Ct. 440, and cases cited. And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. International R. Co. v. Davidson, 257 U.S. 506, 514, 66 L. ed. 341, 346, 42 L. ed. 179. The original regulation as applied to a situation like that under review is both inconsistent with the statute and unreasonable." (pp. 134-135)

In *Helvering v. Sabine Transportation Company*, 318 U.S. 306 (1943) the issue was whether a payment was barred as a dividends paid credit by reason of a regulation enacted by the Commissioner under the Revenue Code. In holding the Regulation unauthorized and therefore invalid the court said:

"It remains to consider the Treasury Regulations promulgated under the 1938 Act. These forbid a credit such as that claimed in this case, calling it a 'double credit.' We think the regulations are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate. They cannot prevail to preclude the credit claimed. The judgment is affirmed." (pp. 311-312)

In *Helvering v. Credit Alliance Corp.*, 316 U.S. 107 (1942) the Supreme Court in holding a Regulation unauthorized and invalid as applied to the facts of the case before it, said:

"In view of what we have said as to the plain meaning of subsection (f), we think that no complexity or confusion is discoverable and that the regulation not only was contradictory of the plain

terms of the subsection but attempted to add a supplementary legislative provision, which could only have been enacted by Congress.” (p. 113)

- (2) The Supreme Court in considering Section 23(a)(2) which also contains a provision allowing the deduction of ordinary and necessary expenses held: that the section is in pari materia with Section 23(a)(1)(A) and that to the extent a regulation bars as a deduction expenses proximately resulting from the conduct of a business, the regulation is invalid.

In *Bingham's Trust v. Commissioner*, 325 U.S. 365 (1945) taxpayer, a testamentary trust, sought to deduct \$16,000.00 in legal expenses incurred in unsuccessfully contesting an additional assessment in income taxes.

Sec. 23(a)(2) of the Revenue Code authorized the deduction of “. . . all the ordinary and necessary expenses paid or incurred . . . for the production or collection of income, or for the management, conservation or maintenance of property held for the production of income.” (p. 368) (italics ours)

Treasury Regulations 103, Sec. 19.23(a)-15 provided:

“expenditures incurred . . . for the purpose of resisting a proposed additional assessment of taxes . . . are not deductible expenses under this section (§23(a)(2) of the Code) . . .” (p. 376)

The Supreme Court in reversing the Circuit Court, held that the Regulation, to the extent it barred the expenditures as a deduction, was invalid.

(1) In defining the words “ordinary and necessary” contained in Sec. 23(a)(2) and in Sec. 23(a)(1) the Court said:

“The requirement of §23(a)(2) that deductible expenses be ‘ordinary and necessary’ implies that they must be reasonable in amount and must bear a reasonable and proximate relation to the management of property held for the production of income.” (p. 370)

“Section 23(a)(2) is comparable and *in pari materia* with §23(a)(1), authorizing the deduction of business or trade expenses. Such expenses need not relate directly to the production of income for the business. It is enough that the expense, if ‘ordinary and necessary’, is directly connected with or proximately results from the conduct of the business. *Kornhauser v. United States*, supra (276 US 152, 153, 72 L ed 506, 507, 48 S Ct 219); *Commissioner of Internal Revenue v. Heininger*, supra (320 US 470, 471, 88 L ed 174, 175, 64 S Ct 249). The effect of §23(a)(2) was to provide for a class of non-business deductions coextensive with the business deductions allowed by §23(a)(1), except for the fact that, since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or in the management or conservation of property held for the production of income.” (pp. 373-374)

“Section 23(a)(2) does not restrict deductions to those litigation expenses which alone produce income. *On the contrary, by its terms and in analogy with the rule under §23(a)(1), the business expense section, the trust, a taxable entity like a business, may deduct litigation expenses when they are directly connected with or proximately result from the enterprise—the management of property held for production of income.*

Kornhauser v. United States, *supra* (276 US 152, 153, 72 L ed 506, 507, 48 S Ct. 219); Commissioner of Internal Revenue v. Heininger, *supra* (320 US 470, 471, 88 L ed 174, 175, 64 S Ct. 249).” (p. 376) (italics ours)

(2) In holding that the Regulation to the extent it contravened the express language of the Code Section was invalid, the Supreme Court in the *Bingham* case said:

“So far as this regulation purports to deny deduction of litigation expense unless it is to produce income, it is not in conformity to the statute, for the reasons already stated, or with the Regulation already mentioned, which provides that in addition to expenses for the production or collection of trust income, expenses of management or conservation of trust property held for the production of income are also deductible. *To that extent and to the extent that it departs from the rule of Kornhauser v. United States, supra, it conflicts with the meaning and purpose of §23(a)(2), and so is unauthorized.* Helvering v. R. J. Reynolds Tobacco Co. 306 US 110, 83 L ed 536, 59 S Ct 423.” (p. 377) (italics ours)

(3) The Supreme Court has held in a series of cases that expenditures incurred for the purpose of preserving an existing method of business are ordinary and necessary within the express language of Section 23(a)(1)(A) beyond question.

In *Commissioner v. Heininger*, 320 U.S. 467 (1943), the Court stated the question before it as follows:

“... whether lawyer's fees and related legal expenses paid by respondent are deductible from his gross income under Section 23(a) of the

Revenue Acts of 1936 and 1938 as ordinary and necessary expenses incurred in carrying on his business." (p. 468)

Taxpayer was a mail order dentist. The expenditures were incurred in unsuccessfully contesting a charge by the Postmaster General that taxpayer's advertising through the mails was fraudulent. As a result of the adverse finding, taxpayer no longer could continue his method of advertising through the mails.

The Tax Court affirmed the disallowance of the expenditures by the Commissioner. The Circuit Court of Appeals reversed the Tax Court. The Supreme Court affirmed the decision of the Circuit Court.

(1) In stating the issue presented by the language of Sec. 23(a), the Supreme Court in the *Heininger* case said:

"There can be no doubt that the legal expenses of respondent were directly connected with 'carrying on' his business. *Kornhauser v. United States*, 276 U.S. 145, 153, 72 L. ed. 505, 506, 48 S. Ct. 219; cf. *Backer's Appeal*, 1 BTA (F) 214; *Pantages Theatre Co. v. Welch* (CCA 9th) 71 F (2d) 68. Our enquiry therefore is limited to the narrow issue of whether these expenses were 'ordinary and necessary' within the meaning of §23(a)." (p. 470)

(2) In holding that the expenditures were ordinary and necessary beyond question, the Supreme Court in the *Heininger* case said:

*"It is plain that respondent's legal expenses were both 'ordinary and necessary' if those words*

*be given their commonly accepted meaning.* For respondent to employ a lawyer to defend his business from threatened destruction was ‘normal’; it was the response ordinarily to be expected. Cf. *Deputy v. Du Pont*, 308 U.S. 488, 495, 84 L. ed. 416, 422, 60 S. Ct. 363; *Welch v. Helvering*, 290 U.S. 111, 114, 78 L. ed. 212, 214, 54 S. Ct. 8; *Kornhauser v. United States*, 276 U.S. 145, 72 L. ed. 505, 48 S. Ct. 219 *supra*. Since the record contains no suggestion that the defense was in bad faith or that the attorney’s fees were unreasonable, the expenses incurred in defending the business can also be assumed appropriate and helpful, and therefore ‘necessary.’” (p. 471) (italics ours)

“Upon being served with notice of the proposed fraud order respondent was confronted with a new business problem which involved far more than the right to continue using his old advertisements. He was placed in a position in which not only his selling methods but also the continued existence of his lawful business were threatened with complete destruction. So far as appears from the record respondent did not believe, nor under our system of jurisprudence was he bound to believe, that a fraud order destroying his business was justified by the facts or the law. *Therefore he did not voluntarily abandon the business but defended it by all available legal means. To say that this course of conduct and the expenses which it involved were extraordinary or unnecessary would be to ignore the ways of conduct and the forms of speech prevailing in the business world.*” (p. 472) (italics ours)

In the more recent case of *Lilly v. Commissioner*, 343 U.S. 90 (1952) the Supreme Court reaffirmed the

holding of the *Heininger* case that expenditures incurred in the interest of preserving the continuation of an existing method of business are ordinary and necessary beyond question.

The issue was whether an optician selling glasses to the public was entitled to deduct under Sec. 23(a) so-called "kick-backs" paid to the physicians who prescribed the glasses. Taxpayer paid the "kick-backs" because otherwise the physicians would have sent the patients to other opticians who paid the same or, on the other hand, the physicians would have filled the prescriptions themselves.

The Supreme Court, in reversing the Circuit Court and in holding in favor of the taxpayer, said with respect to the expenditures:

"The transactions from which they arose were of common or frequent occurrence in the type of business involved. They reflected a nationwide practice. Consequently, they were 'ordinary' in the generally accepted meaning of that word." (p. 93)

"The payments likewise were 'necessary' in the generally accepted meaning of that word. It was through making such payments that petitioners had been able to establish their business." (p. 93)

"As has been said of legal expenses under somewhat comparable circumstances, 'To say that this course of conduct and the expenses which it involved were extraordinary or unnecessary would be to ignore the ways of conduct and the forms of speech prevailing in the business world'.

Commissioner v. Heininger, 320 US 467, 472 . . .". (p. 94)

" . . . Without this expense, there would have been no business. Without the business, there would have been no income. Without the income, there would have been no tax. To say that this expense is not ordinary and necessary is to say that that which gives life is not ordinary and necessary'." (footnote 4, p. 94, quoted from Heininger v. Commissioner (CA 7th) 133 F 2d 567, 570)

In the *Lilly* case the Tax Court had affirmed the disallowance of the expenditure by the Commissioner. In reversing a similar affirmance by the Circuit Court of Appeals, the Supreme Court directed that the case be remanded to the Tax Court with instructions to set aside its judgment insofar as it was inconsistent with the Supreme Court's opinion.

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In the instant proceeding plaintiff taxpayers were engaged in the wholesale distribution of beer to retail customers. Had the Initiative been enacted, the State of Washington would have appropriated to itself the exclusive retail sale of beer; as a result plaintiffs would have lost all their existing customers.

In accordance with the holding of the Supreme Court in the *Heininger* and *Lilly* cases, the expenditures so incurred for the purpose of preserving the continuance of taxpayers' existing business, were "or-

dinary and necessary" within the express language of Sec. 23(a)(1)(A), beyond question.

Application of the Regulation by the Commissioner to bar such expenditures as a deduction directly contravened Sec. 23(a)(1)(A) and was in excess of the rule-making authority of the Commissioner. *Manhattan General Equipment Company v. Commissioner*, 297 U.S. 129 (1936).

Therefore, the Regulation, "to the extent" its application "conflicts with the meaning and purpose of" Sec. 23(a)(1)(A), is unauthorized and invalid in accordance with the holding of the *Bingham* case.

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### III.

#### **THE REGULATION CANNOT BE VALIDLY APPLIED TO BAR THE EXPENDITURES AS A DEDUCTION ON THE GROUND THAT CONGRESS BY RE-ENACTING SECTION 23(a)(1)(A) THEREFORE IMPLIEDLY ADOPTED THE INSTANT APPLICATION OF THE REGULATION AS A PART OF SAID SECTION.**

The Revenue Code was re-enacted during the existence of the Regulation. The doctrine of statutory re-enactment cannot be invoked with respect to the instant application of the Regulation because: the Regulation itself has never been captioned and indexed under Sec. 23(a)(1)(A) but on the contrary for many years has been indexed or captioned under Sec. 23(o) or its predecessor Code sections; the Commissioner himself has publicly acquiesced in a Tax Court decision holding that expenditures incurred in connection with measures voted upon by the People

are deductible under Sec. 23(a). In any event the Supreme Court has held that the doctrine of statutory re-enactment can never be invoked where the application of a Regulation directly contravenes a section of the Revenue Code.

- (1) The theory of statutory re-enactment cannot be invoked because the Regulation itself has never been indexed or captioned under Section 23(a)(1)(A) but on the contrary has been indexed and captioned under Section 23(o) and predecessor Sections.

The Regulation bears the heading “Sec. 29.23(o)-1. Contributions or gifts by individuals.” The history of the Regulation shows that it has been so indexed and captioned ever since the provision regarding lobbying was inserted in the Regulation.

The reference to “23(o)” is a reference to the Section of the Revenue Code bearing the same number, relating to contributions to charitable, religious and educational organizations and bearing the similar title “Charitable and other contributions”.

The context of the Regulation in a number of instances specifically refers to Sec. 23(o). Thus the index of the Regulation, the title of the Regulation and the text of the Regulation specifically refer to Sec. 23(o).

No part of the Regulation makes any specific numerical reference to Sec. 23(a)(1)(A).

The concept, history and purpose of Sec. 23(o) relating to the deduction of contributions to charitable, religious and educational organizations, as previously pointed out, is radically different from the concept,

history and purpose of Sec. 23(a)(1)(A) relating to the deductibility of ordinary and necessary expenses incurred in carrying on a business.

To impute to Congress an implied adoption of the Regulation as a part of Sec. 23(a)(1)(A) is therefore both unreasonable and fictional.

(2) **The Commissioner himself has construed the Regulation as not applicable to expenditures incurred for publicity in connection with measures voted upon by the People.**

The initial Regulation pertaining to corporations bore the title "Lobbying Expenses". The Regulation contained the identical phrase of the instant Regulation "for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda. . . ."

By giving the Regulation pertaining to corporations the title "Lobbying Expenses" the Commissioner plainly construed the words of the Regulation "the promotion or defeat of legislation" as partaking of the same flavor and construction as the word "lobbying" which appears as the opening word of the phrase.

It is also significant that the Supreme Court in the *Textile* case, hereafter considered by us in detail, also construed the same phrase of the Regulation pertaining to corporations as referring to "lobbying" expenses.

The term "lobbying" relates to exertion of influences upon representatives of the People in "legislative halls". Its meaning does not embrace the exercise by an individual of his right of free speech—

exerted publicly for the purpose of influencing a decision by the People at the polls.

In *U. S. v. Rumely*, 345 U.S. 41 (1953), the Supreme Court clearly defined the meaning of the word "lobbying". In that case the issue was whether a Committee of the House of Representatives authorized to investigate "all lobbying activities to influence, encourage, promote or retard legislation" could hold Rumely in contempt for refusal to answer questions regarding books which he sold to the *public*. In holding Rumely was not in contempt and that the questions were unauthorized, the Court said:

"As a matter of English, the phrase 'lobbying activities' readily lends itself to the construction placed upon it below, namely, 'lobbying in its commonly accepted sense,' that is, 'representations made directly to the Congress, its members, or its committees,' 90 App DC 382, 391, 197 F 2d 166, 175, and does not reach what was in Chairman Buchanan's mind, attempts 'to saturate the thinking of the community.''" (p. 47)

In addition to the foregoing construction by the Commissioner of the phrase "for lobbying purposes, the promotion or defeat of legislation" as meaning "lobbying", the Commissioner by his continued published acquiescence in an important decision by the Tax Court next to be considered, has construed the Regulation as not applicable to expenditures incurred for publicity in connection with measures voted upon by the People.

In *Luther Ely Smith v. Commissioner*, 3 T. C. 696 (1944) the issue was whether a taxpayer, a trial law-

yer, could deduct as an ordinary and necessary business expenditure, a contribution of \$2500.00 made to an organization formed for the purpose of amending the Constitution of Missouri by a vote of the People. The proposed amendment provided that judicial candidates of the lower courts should be nominated by a Commission.

The evidence showed that taxpayer's trial practice had suffered under the existing method of selecting judges because his clients had lost confidence in the courts. The contribution was expended for publicity in support of the amendment in the form of radio broadcasting, literature and speeches. The amendment was adopted and being self-operative forthwith became law.

In allowing the deduction the Court held that the expenditures were ordinary and necessary business expenses under Sec. 23(a)(1)(A). The Court expressly stated that its conclusion was based upon the following premise: no lobbying was involved because the amendment was voted upon by the People. No reference was made by the Court to the Regulation because the Court obviously did not consider the Regulation as being applicable.

The Court said:

"It should be noted that the institute engaged in no lobbying of any kind before any legislative body. No legislation was needed or involved in its plan. It contemplated an amendment to the constitution, proposed by the initiative of the people, voted upon at a general election, and be-

coming selfoperative thirty days thereafter, without the necessity of any action or approval by either the legislature or the governor." (p. 702)

The case was decided in 1944 and in the same year the Commissioner acquiesced in the decision, which acquiescence has never been withdrawn (Rev. Rul. 1944-24-11907-C.B. 1944).

- (3) In any event the theory of statutory re-enactment can never be invoked where the application of a Regulation contravenes the express language and meaning of a Section of the Revenue Code.

In *Koshland v. Helvering*, 298 U.S. 441 (1936) the issue was whether taxpayer, the owner of preferred stock who had received a common stock dividend, could upon the sale of the preferred use as his cost basis for computation of income taxes the cost of the preferred without allocating any part of said cost to the common. Obviously if a part of the cost were allocated to the common stock, taxpayer's cost basis would have decreased and conversely his profit and taxes would have increased.

The Commissioner disallowed the claim of taxpayer on the ground that a Treasury Regulation expressly required allocation of a part of the cost to the common.

The pertinent section of the Revenue Code relating to the cost basis of stock had been re-enacted by Congress a number of times during the existence of a Regulation purporting to construe the Section.

The Supreme Court in reversing the Circuit Court of Appeals held that the successive re-enactments of the Code Section did not validate the Regulation as applied to the facts of the *Koshland* case because such application would have contravened the applicable section of the Revenue Code and therefore the Regulation was in excess of the rule-making authority of the Commissioner.

"But we are told that Treasury Regulations long in force require an allocation of the original cost between the preferred stock purchased and the common stock received as dividend. And it is said that while no provision of the statute authorizes a specific regulation respecting this matter, the general power conferred by the law to make appropriate regulations comprehends the subject. Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation. *Congress having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income*

*derived from the capital asset shall be used to reduce cost.”* (pp. 446-447) (italics ours)

The *Koshland* case has never been disproved and was generally approved in the following subsequent cases: *M. E. Blatt Co. v. U. S.*, 305 U.S. 267, 279 (1938); *Helvering v. Oregon Mutual Life Insurance Co.* 311 U.S. 267, 272 (1940); *Social Security Board v. Nierotko*, 327 U.S. 358, 369 (1946).

In the recent case of *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955) the Supreme Court expressly reaffirmed the ruling of the *Koshland* case in the following language:

“It is urged that re-enactment of §22(a) without change since the Board of Tax Appeals held punitive damages nontaxable in *Highland Farms Corp. v. Comissioner*, 42 BTA 1314, indicates congressional satisfaction with that holding. Re-enactment—particularly without the slightest affirmative indication that Congress ever had the *Highland Farms* decision before it—is an unreliable indicium at best. *Helvering v. Wilshire Oil Co.* 308 U.S. 90, 100, 101, 84 L. ed. 101, 107, 108, 60 S. Ct. 18; *Koshland v. Helvering*, 298 U.S. 441, 447, 80 L. Ed. 1268, 1273, 56 S. Ct. 767, 105 ALR 756.” (p. 431)

In *Jones v. Liberty Glass Company*, 332 U. S. 524 (1947), the Supreme Court said:

“Since Congress has subsequently convened from time to time and has amended §322 in other respects without expressly disapproving this interpretation, the contention is advanced that leg-

islative acquiescence in the interpretation must be assumed. But the doctrine of legislative acquiescence is at best only an auxiliary tool for use in interpreting ambiguous statutory provisions." (pp. 533-534)

"We do not expect Congress to make an affirmative move every time a lower court indulges in an erroneous interpretation. In short, the original legislative language speaks louder than such judicial action." (p. 534)

In *Louisville & N.R. Co. v. U. S.*, 282 U.S. 740 (1931) Chief Justice Hughes, speaking for the Court, in holding a Regulation of the Interstate Commerce Commission invalid despite repeated subsequent re-enactments of the Interstate Commerce Act by Congress, said:

"The act has been repeatedly amended, and has been re-enacted, without any change directed to the correction of this practice (i.e.: Interstate Commerce Commission Regulations). It is strongly urged that in the light of these circumstances the administrative construction should be determinative. . . ." (p. 757)

"Long-continued practice and the approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, *but cannot alter provisions that are clear and explicit when related to the facts disclosed.* . . ." (p. 759) (italics ours)

See also *Texas & P. R. Co. v. U. S.*, 289 U.S. 627, 640 (1933) and *U. S. v. Missouri P. R. Co.*, 278 U.S., 269, 279-280 (1929).

The reasoning behind the view that legislative re-enactment can never confer validity upon an administrative regulation which clearly goes beyond the boundaries marked out by the Statute is aptly set forth in *Studies in Federal Taxation, Third Series* by Randolph E. Paul, former Tax Advisor to the Secretary of Treasury, wherein the following statement appears:

“The most familiar limitation upon the doctrine of re-enactment is the qualification that if the regulation definitely goes beyond the limits of the statute, no amount of legislative re-enactment will validate the ruling. *To hold otherwise would mean that taxpayers could never rely upon the clearest terminology of a statute.* A regulation which does not carry into effect the will of Congress as expressed in the statute, and which operates to create a rule out of harmony with the statute, is ‘a mere nullity’.” (p. 435) (italics ours)

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The expenditures here in question incurred in preserving the continuance of an existing business were “ordinary and necessary” within the express language of Sec. 23(a)(1)(A) beyond question. *Commissioner v. Heininger*, 320 U.S. 467; *Lilly v. Commissioner*, 343 U.S. 90.

The Regulation “to the extent” it bars such expenditures as a deduction directly contravenes Sec. 23(a)(1)(A) and its application therefore is invalid. *Bingham’s Trust v. Commissioner*, 325 U.S. 365, 377.

Application of the Regulation to such expenditures "is a mere nullity". *Manhattan General Equipment Company v. Commissioner*, 297 U.S. 129, 134.

The doctrine of statutory re-enactment—that Congress in re-enacting Sec. 23(a)(1)(A), impliedly and in direct contravention of the language of said section adopted such administrative "nullity" by the Commissioner as a part of Sec. 23(a)(1)(A)—cannot therefore be invoked.

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#### IV.

##### THE REGULATION CANNOT BE VALIDLY APPLIED ON THE GROUND OF PUBLIC POLICY TO BAR THE EXPENDITURES AS A DEDUCTION UNDER SEC. 23(a)(1)(A).

- (1) Disallowance of expenditures as a deduction on the ground of public policy can only be justified where expenditures violate sharply defined national and state policies proscribing particular types of conduct.

It is important to first consider in detail a decision by the Supreme Court wherein the Court on the ground of public policy upheld the disallowance by the Commissioner of the deduction of certain expenditures incurred for "lobbying".

In *Textile Mills Sec. Corp. v. Commissioner*, 314 U.S. 326 (1941) the issue was stated by the Court as follows:

"... whether petitioner may deduct under the Revenue Act of [May 29] 1928 (45 Stat. at L. 791, chap. 852, 26 USCA Int. Rev. Acts, 1940 ed. p. 345) certain expenses incurred by it under contracts in connection with the presentation of

claims to Congress on behalf of former enemy aliens for the procurement and enactment of amendatory legislation authorizing the payment of the claims." (p. 327).

Taxpayer, a corporation, had entered into contracts with alien German textile interests for the prosecution of claims and the enactment of legislation for recovery of their property which had been seized in World War I. The contracts were contingent; taxpayer was to receive compensation, which was fixed at a percentage of the recovery, only if the legislation was enacted and in any event was to bear all costs and expenses.

Taxpayer was organized primarily for the purpose of procuring the enactment of such legislation and in the course of its campaign employed the services of a publicist and two legal experts.

Taxpayer was successful in procuring the enactment of the legislation, which was in the form of a monetary award. Taxpayer sought to deduct the expenses for the services previously referred to under Sec. 23(a) as an ordinary and necessary business expense.

The expenditures were incurred in 1929 and 1930 and deducted in the computation of net taxable income for those years. A net loss for those years was carried forward and applied against 1931 income.

Art. 262 of Reg. 74, issued in connection with the 1928 Revenue Act as amended, was entitled "Donations by corporations" and provided:

"Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under §23(n). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. *Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.*" (pp. 336-337) (italics ours)

The Supreme Court, in reversing the Circuit Court of Appeals, held on the ground of public policy that the Regulation could be validly applied to bar the expenditures by taxpayer corporation as a deduction under Sec. 23(a) relating to ordinary and necessary business expenses.

The opinion is short; the quotations hereafter set forth constitute the entire body of the Court's opinion relative to the issue previously stated.

The opinion is divided into two parts, which we will now consider: first, the Court considered whether under the facts the Regulation was applicable to Sec. 23(a) and secondly, if so, whether its application was valid.

(1) In determining whether the Regulation was applicable to the particular expenditures under Sec. 23(a), relating to the deductibility of ordinary and necessary business expenses incurred by a corporation, the Court said:

"Plainly, the regulation was applicable. *The ban against deductions of amounts spent for 'lobbying' as 'ordinary and necessary' expenses* of a corporation derived from a Treasury Decision in 1915. T. D. 2137, 17 Treas. Dec. Int. Rev. pp. 48, 57, 58. That prohibition was carried into Art. 143 of Treasury Regulations 33 (Revised, 1918) under the heading of 'Expenses' in the section on 'Deductions'.<sup>16</sup> Beginning in 1921 the regulation was entitled 'Donations.' (Art. 562, Treasury Regulations 45.) And in the regulations here in question Art. 262 appeared under §23(n) which covered 'Charitable and other contributions' by individuals. It assumed that form and content in 1921 and appeared since then without change in all successive regulations. Section 23(n) and §23(a) both deal with deductions; and a 'donation' by a corporation though not deductible under the former might be under the latter. Article 262 purports to specify when a certain type of expenditure or donation by a corporation may or may not be deducted as an 'ordinary and necessary' expense. The argument that it was not applicable because it was not specifically incor-

porated under §23(a) is frivolous.” (pp. 337-338)  
(italics ours)

In setting forth the history of the Regulation in the paragraph of the opinion previously quoted, the Court, in footnote 16, in turn quoted in full Art. 143, Reg. 33, the initial Regulation bearing the caption “Lobbying Expenses” and containing the same language relating to expenditures “for lobbying purposes, the promotion or defeat of legislation. . . .”

*Comment:*

It is all important to note that the Court at the very outset of the paragraph previously quoted in referring to the text of the Regulation “lobbying purposes, the promotion or defeat of legislation. . . .” characterized the provision as a “*ban* against deductions of amounts spent for ‘lobbying’ . . .” (italics ours).

Footnote 16 of the quotation indicates that the Treasury, in initially publishing the corporate Regulation under the caption “Lobbying Expenses” gave the same characterization to the phrase “lobbying purposes, the promotion or defeat of legislation. . . .”

The Court held that the very use of the language “ordinary and necessary expenses” in the Regulation plainly indicated that the Regulation was referable to Sec. 23(a). Furthermore Sec. 23(a) was the only possible section under which the Regulation relating to corporations could fall because Sec. 23(n) referred to, related only to individuals and Sec. 23(q) relating to charitable and other donations by corporations was not

enacted until 1936—five years later. (The Regulation pertaining to individuals, indexed and captioned under Sec. 23(n) “Charitable and other contributions”, contained neither the foregoing language nor the provision against lobbying. See Appendix for text of said Regulation and also as amended in 1938 by the inclusion of said lobbying provision.)

(2) The Court, in holding that the application of the Regulation to the expenditures so incurred for “lobbying” was valid, said:

“Petitioner’s argument that the regulation is invalid likewise lacks substance. The words ‘ordinary and necessary’ are not so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation. The numerous cases which have come to this Court on that issue bear witness to that, Welch v. Helvering, 290 U.S. 111, 78 L ed 212, 54 S Ct 8; Deputy v. DuPont, 308 U.S. 488, 84 L ed 416, 60 S Ct 363, and cases cited. *Nor has the administrative agency usurped the legislative function by carving out this special group of expenses and making them non-deductible.* We fail to find any indication that such a course contravened any Congressional policy. *Contracts to spread such insidious influences through legislative halls have long been condemned.* Trist v. Child (Burke v. Child) 21 Wall. (US) 441, 22 L ed 623; Hazelton v. Sheckells, 202 US 71, 50 L ed 939, 26 S Ct. 567, 6 Ann Cas 217. Whether the precise arrangement here in question would violate the rule of those cases is not material. The point is that the general policy indicated by those cases need not be disregarded by the rule-making authority in

its segregation of non-deductible expenses. *There is no reason why, in absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction.* The exclusion of the latter from ‘ordinary and necessary’ expenses certainly does no violence to the statutory language. The general policy being clear it is not for us to say that the line was too strictly drawn.” (pp. 338-339) (italics ours)

*Comment:*

In stating that the administrative agency had not usurped the legislative function by carving out “this special group of expenses and making them non-deductible”, the Court plainly was referring to “lobbying” expenditures—the characterization given such expenditures in the previous paragraph of the Court’s opinion.

Both cases, *Trist v. Child* and *Hazelton v. Sheckells*, cited by the Court in support of its statement that “contracts to spread such insidious influences through legislative halls have long been condemned” were cases involving contingent fee contracts for the enactment of legislation by means of “lobbying” in “legislative halls”. The Supreme Court in each of said cases held the contracts unenforceable on the ground of public policy. (italics ours)

The Court in the *Textile* case plainly stated that the application of the Regulation to bar the expenditures was based upon public policy as declared by the

Court in the *Trist* and *Hazelton* cases. The Court, however, in a footnote (f.n. 18, p. 338) made a passing and incidental reference to the fact that Congress in 1936 in enacting Sec. 23(q) of the Code relating to the deduction by corporations of contributions to charitable, religious and educational organizations, inserted a proviso that no substantial part of the activities of such organization shall be carrying on propaganda, or otherwise attempting, to influence legislation. The reference was not intended to have any significance other than one of passing interest because the transactions involved in the *Textile* case took place in 1929-1931, at least five years prior to the amendment referred to. Furthermore, as previously pointed out in this brief, the purpose and concept of the distinct sections of the Revenue Code relating to contributions by corporations and individuals to charitable, religious and educational organizations are radically different from the purpose and concept of Sec. 23(a)(1)(A) relating to business expenses.

In any event the Court made it crystal clear that the public policy which the Court was referring to was the public policy declared by the *Trist* and *Hazelton* cases. The Court said:

“The point is that the *general policy* indicated by *those cases* need not be disregarded by the rule-making authority in its segregation of non-deductible expenses”. (italics ours)

The Court subsequently reiterated the limited scope of the public policy declared in those cases by stating that it saw no reason why “the rule-making authority

cannot employ that general policy in drawing a line between legitimate business expenses and those arising from *that family of contracts* to which the law has given no sanction" (italics ours). The reference to "that family of contracts" is to contracts referred to in the cases cited, which were for the enactment of legislation on a contingent fee basis involving "lobbying" in "legislative halls".

Thus the decision of the Supreme Court in the *Textile* case, giving it the broadest scope possible, may be summarized as holding: that the Regulation may be validly applied on the ground of public policy to bar certain types of expenditures incurred for "lobbying" in "legislative halls".

The Supreme Court in two subsequent decisions confirmed the same limited construction of its previous holding in the *Textile* case.

In *Commissioner v. Heininger*, 320 U.S. 467 (1943), previously considered, the issue was whether: expenditures incurred by a mail order dentist in unsuccessfully resisting a fraud order of the Postmaster General were ordinary and necessary business expenses and also whether the allowance of the expenditures as a deduction would violate public policy.

In holding that the allowance of the expenditures would not violate public policy, the Court said:

"The Bureau of Internal Revenue, the Board of Tax Appeals, and the federal courts have from time to time, however, narrowed the generally accepted meaning of the language used in §23(a) in order that tax deduction consequences might

not frustrate sharply defined national or state policies proscribing particular types of conduct. A review of the situations which have been held to belong in this category would serve no useful purpose for each case should depend upon its peculiar circumstances. A few examples will suffice to illustrate the principle involved. Where a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction for its payment. *Similarly, one who has incurred expenses for certain types of lobbying and political pressure activities with a view to influencing federal legislation has been denied a deduction.”* (italics ours) (p. 473)

Footnote 9 in the previous quotation cites the *Textile* case in support of the statement which has been italicized.

In connection with the statement that public policy can be invoked only where to allow the deduction would violate “sharply defined national or state policies proscribing particular types of conduct” the Court said:

“The language of §23(a) contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible.” (p. 474)

It is pertinent to note that in 1913 at the time the original bill enacting the income tax law was debated in the Senate, Senator Sterling proposed an amendment that any deduction of expenses and losses should be incurred in “legitimate trade”. The amendment

was vigorously opposed and rejected. Senator Williams, a ranking member of the Finance Committee who was in charge of the bill, in reply to the proposed amendment, pointed out that the object of the bill was to tax income: "It is not to reform men's moral characters; that is not the object of the bill at all." (Vol. 50 Cong. Rec., p. 3849 et seq. (1913) )

In the recent case of *Lilly v. Commissioner*, 343 U.S. 90 (1952) previously considered, the issue was whether "kick-backs" paid by a dispensing optician were ordinary and necessary business expenses and further whether an allowance of the expenditures as a deduction would violate public policy.

The Supreme Court in holding that allowance of the deduction would not violate public policy said:

"In *Textile Mills Securities Corp. v. Commissioner*, 314 US 326, 86 L ed 249, 62 S Ct 272, this Court accepted an interpretation of that section by a Treasury Regulation which disallowed the deduction of *certain expenditures for lobbying purposes*. In doing so, the Court referred to the fact that some types of lobbying expenditures had long been condemned by it. . . ." (p. 95) (italics ours)

The Court then quoted from the *Heininger* case with italics supplied by the Court as follows:

"It refers to the narrowing of 'the generally accepted meaning of the language used in §23(a) in order that tax deduction consequences *might not frustrate sharply defined national or state policies* proscribing particular types of conduct.' (Emphasis supplied.)" (p. 96)

In holding that an allowance of the deduction would not violate public policy the Court said:

“The policies frustrated must be national or state policies evidenced by some governmental declaration of them.” (p. 97)

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Thus the Supreme Court in the *Heininger* and *Lilly* opinions clearly reiterated the limited holding of the *Textile* case to the *facts* before the Court in that case: that the Regulation could be validly applied on the ground of public policy to bar as a deduction certain types of expenditures for “lobbying” in “legislative halls” referred to in the *Textile* case.

The gross error of extending statements by the Supreme Court to different facts in a different setting was the subject of sharp comment by the Supreme Court in *Armour & Co. v. Wantock*, 323 U.S. 126 (1944), where the Court said:

“It is timely again to remind counsel that words of our opinions are to be read in the light of the facts of the case under discussion . . . General expressions transposed to other facts are often misleading.” (pp. 132-133)

It is all important to bear in mind that the issue in this case is not the issue whether the Regulation is valid as an abstraction. The issue on the contrary is the specific question whether the Regulation can be validly applied to the expenditures in question. Whether the Regulation may be validly applied to

other and different expenditures under different circumstances is not in issue.

It is also important to note that the Supreme Court in the *Heininger* case held that the question whether expenditures can be disallowed on the ground of public policy turns on the facts of each particular case. In referring to "sharply defined national or state policies proscribing particular types of conduct" the Supreme Court said:

"A review of the situations which have been held to belong in this category would serve no useful purpose for each case should depend upon its peculiar circumstances." (p. 473)

We therefore come to the next question: whether a deduction of the expenditures in question could violate any conceivable public policy.

- (2) The expenditures here incurred for publicity in connection with an Initiative Measure voted upon by the People did not violate any conceivable public policy but on the contrary were in the interests of public policy.

The expenditures here incurred were not "for lobbying" in "legislative halls" — the expressions used in the *Textile* case. The term "lobbying", said the Supreme Court in *U. S. v. Rumely*, 345 U.S. 41 (1953) "does not reach what was in Chairman Buchanan's mind, 'attempts to saturate the thinking of the community'." (p. 47)

The expenditures were incurred by plaintiff taxpayers, as individuals, for publicity directed to the People, in the exercise of their right of free speech

and for the purpose of preserving the continuance of their existing business.

The ballot title of the Initiative Measure submitted to the People of Washington at the General Election held November 2, 1948 was: "An Act prohibiting the retail sale of beer and wine by any person other than the State of Washington, repealing all provisions of existing law pertaining to licensing of retail sale of beer and wine, revoking existing licenses and providing penalties." (TR. 45)

The State of Washington expressly declared as a matter of public policy that information for and against the Initiative should be given to the public. State law provided that proponents and opponents of the Initiative had the right to present their views to the public in a pamphlet containing a copy of the Initiative mailed by the State to all voters prior to the election; the cost of printing such arguments to be paid for by the parties so presenting their views (Revised Code of Washington, Sec. 29.79.340) (TR. 92-101).

Opponents of the Initiative, accordingly, at their expense, availed themselves of the opportunity so afforded by law to present their views. Taxpayers, together with others, supplemented that presentation to the public by making the expenditures here in question and for the following purposes:

"A. Well, the principal activity was newspaper advertising and radio broadcasting. There were large quantities of literature distributed through various channels." (TR. 115)

"The Witness: It was directed as a means of educating the public as to the nature of the initiative measure which they would otherwise not know.

The Court: All with the view of procuring its non-adoption?

The Witness: That is right." (TR. 116)

The District Court in its oral decision expressly held that the expenditures did not violate any public policy and on the contrary held that the expenditures were in the public interest:

"It is admitted in the record that the sums here in question were spent by the taxpayer for the purpose of defeating the enactment of certain legislation by initiative and that being so, those sums are not deductible from gross income. This is not to indicate that there is anything evil or corrupt about spending money for these purposes. Quite the contrary. The expenditure of money to enlighten and inform the public with respect of initiative measures is a perfectly proper and laudable activity. When the general public are called upon to enact or refuse to enact legislation, the more information they are given and the more widespread it is distributed the better. Certainly neither this taxpayer nor the Washington Brewers Institute nor the brewing industry are in any manner to be criticized for having spent the money to defeat the legislation by fair publicity. They had a right to do that and propriety of expenditures therefor is not in question. But that has nothing whatever to do with whether the sums so spent by the taxpayer are deductible for income tax purposes. In that

matter the regulation is controlling and clearly requires judgment in favor of defendant. So ordered." (TR. 29-30) (Complete oral opinion of the Court is set forth in the Appendix) (See also Conclusion of Law No. 2 to the same effect—TR. 35).

In our research of the cases on public policy we were unable to find a single case even intimating that expenditures incurred in informing the People regarding a measure submitted to their vote are against public policy. On the contrary, information given in the exercise of the right of free speech guaranteed by the Constitution is protected and encouraged by the law to the fullest extent. The potential evils involved in connection with certain expenditures incurred in "lobbying" in "legislative halls" simply do not and cannot exist where an open appeal is made directly to the People with respect to a measure submitted to a vote of the People.

The Commissioner himself by his published acquiescence in the *Luther Ely Smith* case, previously referred to, has expressly recognized that such expenditures made in connection with a measure voted upon by the People do not violate any public policy. It is significant that the acquiescence by the Commissioner in the *Luther Ely Smith* case was announced subsequent to the decision in the *Textile* case and has not been withdrawn.

The Supreme Court in the *Textile* case clearly only construed the Regulation pertaining to corporations as applicable to certain types of expenditures incurred

for "lobbying" in "legislative halls". In the subsequent *Heininger* and *Lilly* cases the Supreme Court clearly reaffirmed such construction.

And see *Steele v. Drummond*, 275 U.S. 203, 205, 206 (1927) where the Supreme Court clearly pointed out that of the various types of activities engaged in to influence passage of legislation, only certain categories of activities are against public policy: the obtaining of legislative action "as a matter of favor by means of personal influence, solicitation and the like, or by other improper or corrupt means."

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## V.

### AUTHORITIES CITED BY THE DISTRICT COURT: THE ULTIMATE DECISIONS OF SAID CASES ARE NOT NECESSARILY INCONSISTENT WITH THE DECISIONS OF THE SUPREME COURT PREVIOUSLY CITED.

The District Court in support of its Conclusions of Law and in its Opinion, cited a number of decisions by the lower courts, including two decisions by the U. S. Court of Appeals for the Ninth Circuit (TR. 27, 47-48; See Appendix).

These cases will now be considered in the same order in which they have been cited by the District Court.

*Old Mission Portland Cement Co. v. Commissioner*, 69 F. 2d 676 (9th Cir. 1934):

The Regulation was not considered by the Court. The issue was whether taxpayer, engaged in manu-

factoring cement in California, could deduct \$3,000.00 contributed in 1926 "to promote a state-wide referendum for an increased gasoline sales tax levy in order to provide additional funds for road building." (p. 677)

The referendum was successful and large quantities of cement were used for additional roads of which taxpayer supplied a part.

The opinion does not indicate how the contribution was expended except to note that the contribution was listed on taxpayer's books as "All California Highway Lobbying \$3,000." (p. 681)

The Circuit Court affirmed the Board of Tax Appeals, which Board in turn had affirmed a disallowance of the contribution by the Commissioner.

The opinion of the Court deals with a number of other transactions from which an appeal was also taken. The Court disposed of the issue relating to the contribution with the brief statement that it "is not such an outlay as constitutes an ordinary and necessary business expense." (p. 681)

*Comment — Old Mission case:*

The following aspects of the contribution so made are significant: (1) The contribution only remotely and indirectly affected taxpayer's business. Thus if the referendum were enacted, taxpayer might or might not get some business depending upon other conjectural factors such as price and terms; (2) Taxpayer's books listed the contribution as "Lobbying"

and taxpayer testified that the term so used was correct. The Opinion does not indicate how the money was actually expended.

In view of the foregoing features of the contribution, the Circuit Court was justified in upholding the factual finding of the Board of Tax Appeals that the contribution was not an ordinary and necessary business expense. The Regulation was not mentioned.

*Sunset Scavenger Co. v. Commissioner*, 84 F. 2d 453 (9th Cir. 1936) :

A Regulation pertaining to corporations containing a provision with respect to lobbying, the promotion or defeat of legislation was before the Court. The following facts of the case appear collectively in the opinion of the Circuit Court, in the opinion of the Board of Tax Appeals and from an examination of the records of the case.

Taxpayer was engaged in the business of collecting garbage in San Francisco. In 1927 taxpayer expended \$34,485.00 in opposing an ordinance submitted to the voters of San Francisco in the form of an Initiative which would have permitted additional garbage licenses upon the request of a specified number of householders in a given area. The method of licensing provided in the measure was in addition to the existing method of licensing.

In 1929 taxpayer expended the sum of \$1600.00 in connection with a number of propositions submitted by the Board of Supervisors to the voters as "Dec-

larations of Policy". The propositions so submitted inquired whether the voters were in favor of the municipal collection of garbage. The expression of "policy" by the voters was subject to rejection or acceptance by the Board of Supervisors of San Francisco, who independently were authorized under law to pass on the question whether legislation for the municipal collection of garbage should be enacted.

The monies in both years were expended in printing and distribution of pamphlets, newspaper advertising and in engaging speakers.

The opinion of the Circuit Court in reversing the allowance of the expenditures by the Board of Tax Appeals may be summarized as follows: (1) after referring to Sec. 234(a)(1) (the predecessor of Sec. 23(a)), the Court without further consideration of said Section held the Regulation was applicable; (2) the Court observed that reenactment of the Revenue Code during the existence of the Regulation was indicative that the Regulation was not inconsistent with the statute; (3) the Court concluded its opinion with the statement that its holding was in accord with the *Old Mission* case.

*Comment — Sunset case:*

(1) It will be observed that the expenditures incurred in 1927 in the sum of \$34,485.00 were used to combat an ordinance providing for an alternative method of licensing scavengers which was supplemental to the existing method of licensing. Whether, and to what extent, the taxpayer upon the enactment

of the ordinance would have lost business because of greater facility in the issuance to competitors of licenses under the ordinance, was conjectural and dependent upon future events. Therefore, enactment of the ordinance in itself did not directly and immediately affect taxpayer's business or its method of doing business.

The expenditure of \$1600.00 in 1929 related to a measure which was not an ordinance but instead a declaration of policy which the Board of Supervisors thereafter could accept or reject. Adoption of the measure therefore did not directly or immediately affect taxpayer's business. The ultimate target of the expenditures incurred for publicity may, therefore, be said to have been legislative action by the Board of Supervisors.

In view of the conjectural and indirect effect of the adoption of both the measures upon taxpayer's business, the facts of the *Sunset* case are quite different from the facts of the instant case where it is clear and beyond question that taxpayers, upon the adoption of the Initiative, would have forthwith lost all their existing customers. Thus the facts in the *Sunset* case did not raise any clear-cut test whether the Regulation pertaining to corporations could be validly applied. Furthermore the Court did not have before it the benefit of the holdings of the Supreme Court in the subsequent *Heininger* and *Lilly* cases: that expenditures incurred in preserving the continuance of an existing business are ordinary and necessary with-

in the meaning of Sec. 23(a)—beyond question. Nor did the Court have the benefit of the holding of the Supreme Court in the subsequent *Textile* case.

(2) With respect to the reenactment of the Revenue Code during the existence of the Regulation, as indicative of implied Congressional adoption of the Regulation, it is significant to note that the Court added the all-important qualification to its statement on that subject: ". . . unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it." (p. 457)

It should also be noted that the provision with respect to lobbying was not included in the Regulation pertaining to individuals until some nine years after the occurrence of the facts in the *Sunset* case.

(3) The Court in conclusion rested its final decision upon its prior holding in the *Old Mission* case in the following language: "This conclusion is in accord with *Old Mission Portland Cement Co. v. Commissioner* (C.C.A. 9) 69 F. (2d) 676, affirmed on other issues, *Old Mission Portland Cement Co. v. Helvering*, 293 U.S. 289, 55 S. Ct. 158, 79 L. Ed. 367." (p. 457) (italics ours)

We previously pointed out that the facts in the *Old Mission* case justified a decision by the Circuit Court upholding the finding of the Board of Tax Appeals that the expenditures were not ordinary and necessary. In supporting its final conclusion on the authority of the *Old Mission* case, where no Regulation was considered or mentioned, the Court in the *Sunset* case

plainly indicated that it found the expenditures were not ordinary and necessary aside from any application of the Regulation. On that issue it may well be contended as previously stated that the facts did not clearly show that the expenditures were ordinary and necessary beyond question.

(4) Neither the opinion of the Circuit Court nor the Board of Tax Appeals indicates that the measures were submitted to the voters. Only a search of the records disclosed that the measures were submitted to the voters. The Circuit Court apparently did not regard that feature of the case as significant. The opinion nowhere mentions the subject of public policy. The Court of course did not have the benefit of the subsequent holding by the Supreme Court in the *Textile* case (affirmed in the subsequent *Heininger* and *Lilly* cases) wherein the Court upheld the validity of the Regulation pertaining to corporations, on the ground of public policy only, as applied to the facts before it: certain types of expenditures incurred for "lobbying" in "legislative halls". Nor did the Court have the benefit of the holding of the Supreme Court in the subsequent *Rumely* case that the term "lobbying" does not include publicity directed to the People. Also, the acquiescence of the Commissioner in the *Luther Ely Smith* case, wherein the Tax Court held that expenditures incurred in connection with measures voted upon by the People were deductible, was first published by the Commissioner in 1944—long after the decision in the *Sunset* case.

*Roberts Dairy Co. v. Commissioner*, 195 F. 2d 948 (8th Cir. 1952) :

The Regulation pertaining to corporations was before the Court. The issue was whether taxpayer, engaged in the distribution of milk, could deduct contributions to the National Tax Equality Association. Taxpayer was in competition with cooperative dairies who unlike taxpayer were exempt as legal entities from income taxes. The Association was incorporated to conduct "educational, scientific and research activities . . ." and as such had obtained a tax exemption.

Congress in 1943 enacted legislation revising the income tax laws, lessening the tax advantages accorded cooperatives. The Association incurred expenditures for the purpose of persuading Congress to enact the legislation. The Association in its reports to members claimed the legislation had been enacted through its efforts.

The Circuit Court, in affirming the Tax Court, held :  
(1) The work of the Association "was to persuade congress and legislatures" to remove tax disparities;  
(2) the Court then, without elaboration or citation of any authority stated that the contribution was not deductible "within the meaning of §23(q)(2) of the Internal Revenue Code and §29.23(q)-1 of Treasury Regulation 111." (p. 950) (the section of the Revenue Code so referred to relates to the deduction of religious, charitable, scientific, educational and similar contributions by corporations.)

Our comment regarding the *Roberts Dairy* case is combined with our comment with respect to a companion case which will be considered next.

*American Hardware & Equipment Co. v. Commissioner*, 202 F. 2d 126 (4th Cir. 1953) :

Here again the issue was whether contributions to the National Tax Equality Association were deductible. The facts were the same as the facts in the *Roberts Dairy* case except that taxpayer was in the hardware business.

In affirming the decision of the Tax Court, the Circuit Court stated: (1) that the contributions were neither deductible under "Sec. 23(n)" (sic) as "scientific or educational" contributions, nor as a business expense under Sec. 23(a); (2) the Court referred to the Regulations and stated that the Supreme Court in the *Textile* case had held the Regulation applicable to such expenditures.

*Comment—Roberts Dairy and American Hardware cases:*

In each of said cases the expenditures were incurred in connection with legislation pending in "legislative halls". In considering the issue involved in the instant appeal, it is not necessary to consider further whether the expenditures so incurred were within "certain types of lobbying" expenditures, which should be disallowed as a deduction on the ground of public policy, referred to by the Supreme Court in the

*Heininger* and *Lilly* cases in construction of the holding of the Court in the *Textile* case. It is significant that the Circuit Courts in the *Roberts Dairy* and *American Hardware* cases failed to mention the decisions by the Supreme Court in the *Heininger* and *Lilly* cases.

*Revere Racing Association v. Scanlon*, 137 F. Supp. 293 (D. Mass. 1955) :

The question was: whether taxpayer, engaged in operating a dog racetrack, could deduct expenditures made to persuade voters at a General Election to approve dog betting for an additional four years. The law provided for an election every four years as to whether dog betting should legally be permitted.

The Court after referring to the Regulation pertaining to corporations indicated that the expenditures were barred by the Regulation. The Court then stated:

“Even if the activities of the plaintiff did not come within Treasury Regulation 111, Sec. 29.23 (q)-1, I think that they cannot properly be classified as proper business deductions under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.” (p. 294)

“These expenses were not the expenses of doing business in any sense of the word, but were to put the voters in a frame of mind that would give them a possible opportunity to do business later.” (p. 294)

The decision was appealed to the Circuit Court of Appeals, which decision we will now consider (not

cited, however, by the District Court in its Conclusions of Law and Opinion in the instant proceeding).

In *Revere Racing Association v. Scanlon*, 232 F. 2d 816 (1st Cir. 1956), the Circuit Court, in affirming the District Court stated: (1) The expenditures incurred were similar to those incurred in *McDonald v. Commissioner*, 323 U.S. 57 (1944), wherein a distinction was drawn between expenditures incurred in being a Judge and expenditures incurred by a Judge in endeavoring to be re-elected. The Court pointed out that the expenditures incurred by taxpayers were for the following purpose: "to put the voters in a frame of mind that would give them a possible opportunity to do business later." (p. 818) The Court of course was plainly referring to the fact that taxpayer's license to engage in dog racing was dependent upon a vote by the voters every four years. The Court said: "Accordingly we believe the McDonald decision controls the instant case." (p. 818) (2) The Court then said it likewise agreed with the lower Court that the Regulation applied even though the expenditures were made to influence voters rather than members of the legislature, citing the *Textile* case.

*Comment—Revere case:*

(1) In *McDonald v. Commissioner*, supra, upon which the Circuit Court based its opinion, the expenditures were made by a Judge in campaigning for re-election. In holding the expenditures so made were not deductible the Supreme Court first pointed out that

Sec. 48(a) of the Revenue Code expressly provided that the performance of a judicial office is a trade or business and that, accordingly, Sec. 23(a), allowing the deduction of ordinary and necessary expenses in carrying on a business was applicable. The Court said:

“But his campaign contributions were not expenses incurred in being a judge but in trying to be a judge for the next ten years.” (p. 60)

The expenditures incurred in the *Revere* case in the course of a mandatory election held every four years for the purpose of determining whether taxpayer could engage in dog racing for the ensuing four-year period, were no different than the expenditures incurred in the *McDonald* case for the purpose of being re-elected a Judge.

In contrast, in the instant case taxpayers had a present right to continue in business indefinitely. Thus taxpayers' expenditures were incurred in preserving and carrying on an “existing” business rather than in seeking to engage in a future business.

(2) The statement by the Court that it likewise agreed with the lower Court that the Regulation was applicable although the expenditures were made to influence voters rather than legislators, was admittedly dictum because the Court expressly stated that the *McDonald* decision “*controls the instant case*”. (p. 818) (italics ours)

In any event for reasons herein previously stated, the statement of the Court that the Regulation could

be properly applied to expenditures incurred to influence voters is not supported by the *Textile* case. The Court in the *Textile* case clearly pointed out that the application of the Regulation to the expenditures there considered was based on public policy: requiring the disallowance of certain types of expenditures incurred for "lobbying" in "legislative halls". The Supreme Court in the subsequent *Heininger* and *Lilly* cases clearly reaffirmed said construction of the *Textile* case and further held that the public policy barring the deduction must be sharply defined public policy—proscribing particular types of conduct. Those two later decisions by the Supreme Court were not considered in the *Revere* case. The Supreme Court further held in the *Rumely* case that "lobbying" does not embrace an appeal made directly to the People.

In addition, the foregoing statement by the Court in the *Revere* case was inconsistent with the published acquiescence of the Commissioner in the *Luther Ely Smith* case, which latter case was not mentioned by the Court.

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Thus the ultimate decisions of the cases cited by the District Court in its Conclusions of Law and Opinion are not necessarily in conflict with the final conclusion expressed in this brief. To the extent, however, that any statements appear in the opinions of

those decisions to the contrary, such statements must yield to the superior authority of the Supreme Court decisions previously considered.

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#### **CLOSING SUMMARY AND CONCLUSION.**

The Regulation cannot be validly applied to bar the expenditures here incurred as a deduction under Sec. 23(a)(1)(A) on the basis of any of the three only justifiable grounds for any possible valid application of the Regulation:

- (1) **The Regulation cannot be validly applied on the ground that its application falls within the authorized rule-making authority of the Commissioner.**

“He was placed in a position in which not only his selling methods but also the continued existence of his lawful business were threatened with complete destruction. . . . It is plain that respondent’s legal expenses were both ‘ordinary and necessary’ if those words be given their commonly accepted meaning.”  
*Commissioner v. Heininger*, 320 U.S. 467 (pp. 472, 471)

“The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.” *Man-*

*hattan General Equipment Company v. Commissioner*,  
297 U.S. 129 (p. 134)

The Regulation "to the extent" it bars a deduction of the expenditures here in question is in contravention of the will of Congress expressed in Sec. 23(a) (1)(A) and hence to that "extent" is invalid. *Bingham's Trust v. Commissioner*, 325 U.S. 365 (p. 377)

**(2) The Regulation cannot be validly applied on the ground of statutory re-enactment.**

The Regulation at all times has been captioned "Contributions or gifts by individuals" and has been indexed under Sec. 23(o) of the Code relating to "Charitable and Other Contributions" by individuals. The body of the Regulation in referring to its application, at all times has made specific numerical reference to Sec. 23(o). The Regulation has never contained any specific numerical reference to Sec. 23(a)(1)(A).

The Commissioner himself by his published acquiescence in the *Luther Ely Smith* decision (3 T.C. 696) has officially construed the Regulation as not applicable to expenditures incurred in connection with measures voted upon by the People.

The Supreme Court has construed the phrase of the Regulation "for lobbying purposes, the promotion or defeat of legislation . . ." as "the ban against deductions of amounts spent for 'lobbying'." *Textile Mills Sec. Corp. v. Commissioner*, 314 U.S. 326 (p. 337) (italics ours).

The term "lobbying" does not embrace "attempts to saturate the thinking of the community." *U. S. v. Rumely*, 345 U.S. 41 (p. 47).

In view of the foregoing, to impute to Congress an implied adoption of the instant application of the Regulation as a part of Sec. 23(a)(1)(A) is unreasonable and fictional.

The Supreme Court has held that expenditures incurred for the preservation of a taxpayer's business are "ordinary and necessary" and therefore fall within Sec. 23(a) beyond question. Hence the instant application of the Regulation contravenes Sec. 23(a). The doctrine of statutory re-enactment, therefore, in any event, cannot be invoked with respect to the instant application of the Regulation. "But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation." *Koshland v. Helvering*, 298 U.S. 441 (p. 447).

"Long-continued practice and the approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, but cannot alter provisions that are clear and explicit when related to the facts disclosed." *Louisville & N. R. Co. v. U. S.*, 282 U.S. 740 (p. 759) (italics ours).

"To hold otherwise would mean that taxpayers could never rely upon the clearest terminology of a statute." *Studies on Federal Taxation, Third Series*, Randolph E. Paul (p. 435).

Application of a Regulation which "operates to create a rule out of harmony with the statute, is a mere *nullity*". *Manhattan General Equipment Company v. Commissioner*, 297 U.S. 129 (p. 134) (italics ours)

The initial and continuing "*nullity*" of the application of the Regulation to expenditures of the type incurred in the instant case cannot be transformed into a *validity* under any theory of statutory re-enactment.

(3) **The Regulation cannot be validly applied on the ground of public policy.**

Public policy may be invoked only where it is clear that to allow a deduction of the expenditures would "frustrate sharply defined national or state policies proscribing particular types of conduct." *Commissioner v. Heininger*, 320 U.S. 467 (p. 473). "The policies frustrated must be national or state policies evidenced by some governmental declaration of them." *Lilly v. Commissioner*, 343 U.S. 90 (p. 97). Such public policy must be "sharply defined" because "The language of Sec. 23(a) contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible." *Commissioner v. Heininger*, supra at p. 474.

In determining whether public policy can be invoked to bar expenditures as a deduction the particular facts of each case must be considered "... for each case should depend upon its peculiar circum-

stances . . .". *Commissioner v. Heininger*, supra at p. 473.

An allowance of the expenditures in question cannot violate any conceivable public policy. "Quite the contrary. The expenditure of money to enlighten and inform the public with respect of initiative measures is a perfectly proper and laudable activity. When the general public are called upon to enact or refuse to enact legislation, the more information they are given and the more widespread it is distributed the better." *Opinion of the District Court* (Tr. 29; see Appendix)

The Commissioner himself has expressly acknowledged that public policy is not violated where expenditures are incurred in connection with measures submitted to a vote of the People [Commissioner's Acquiescence in *Luther Ely Smith* case, Rev. Rul. 1944-24-11907-C.B. 1944].

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Taxpayers incurred the expenditures here as individuals in the exercise of their fundamental right of free speech and in the interest of preserving the continuance of their existing business. By disallowing the expenditures the Commissioner has imposed a drastic practical penalty on the exercise of those rights.

The Commissioner's sole justification in so doing is a Regulation issued by him. And this despite the holding of the Supreme Court that such expenditures are "ordinary and necessary"—the express declaration of

Congress that all "ordinary and necessary" expenses are deductible—the repeated holdings of the Supreme Court that a Regulation to the extent that its application contravenes the will of Congress is invalid.

The lower Court in upholding the action of the Commissioner gave no consideration at all to the question whether the Regulation as applied to the specific facts before the Court was in excess of the rule-making authority of the Commissioner. The lower Court merely relied on the language of the Regulation in the abstract and without more.

In so accepting the "shell" of the Regulation without examining the "kernel"—the basic question of the Commissioner's authority to apply the Regulation to the instant facts—the lower Court erred.

In 1574, Serjeant Plowden in *Eyston v. Studd*, Plowden's Reports (p. 465) said: "Our law, like all others, consists of two parts viz, of body and soul. The letter of the law is the body of the law, and the sense and reason of it is the soul, *quia ratio legis est anima legis*. And the law may be resembled to a nut, which has a shell, and a kernel within; the letter of the law represents the shell, and the sense of it the kernel. So you will receive no benefit by the law if you rely upon the letter."

In view of the decisions of the Supreme Court clearly demonstrating that the instant application of the Regulation contravenes the will of Congress expressed in Sec. 23(a), and in view of the absence of any valid or reasonable grounds for applying the Reg-

ulation to the instant expenditures, we respectfully urge that this Court find: that the Regulation cannot be validly applied to bar the instant expenditures as a deduction; that this Court further find that the instant expenditures are "ordinary and necessary" within the meaning of Sec. 23(a); that accordingly the judgment of the District Court be reversed.

Dated, March 7, 1957.

Respectfully submitted,

ATHEARN, CHANDLER & HOFFMAN,

By WALTER HOFFMAN,

CLARK W. MASER,

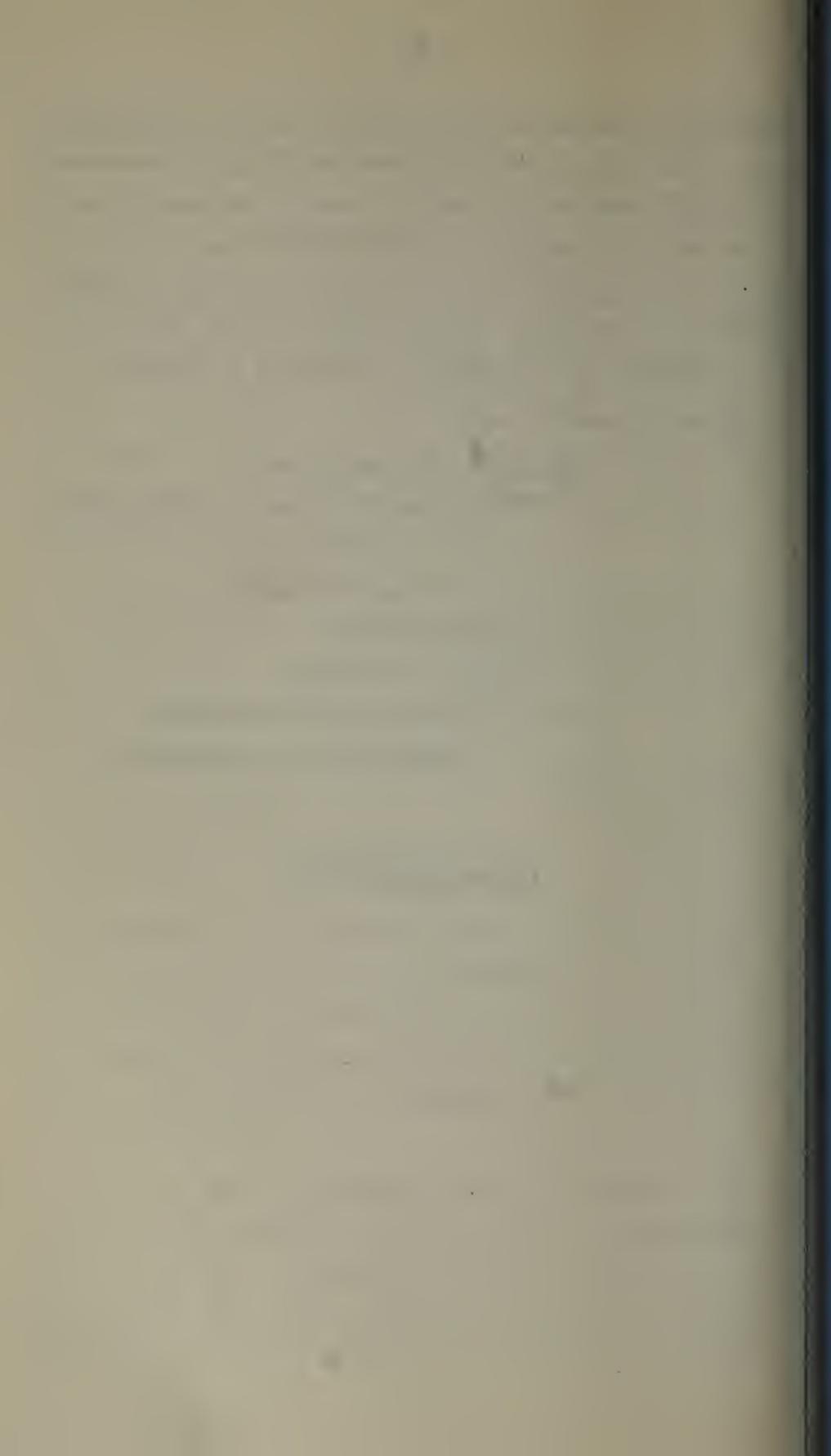
JONES & GREY,

By A. R. KEHOE,

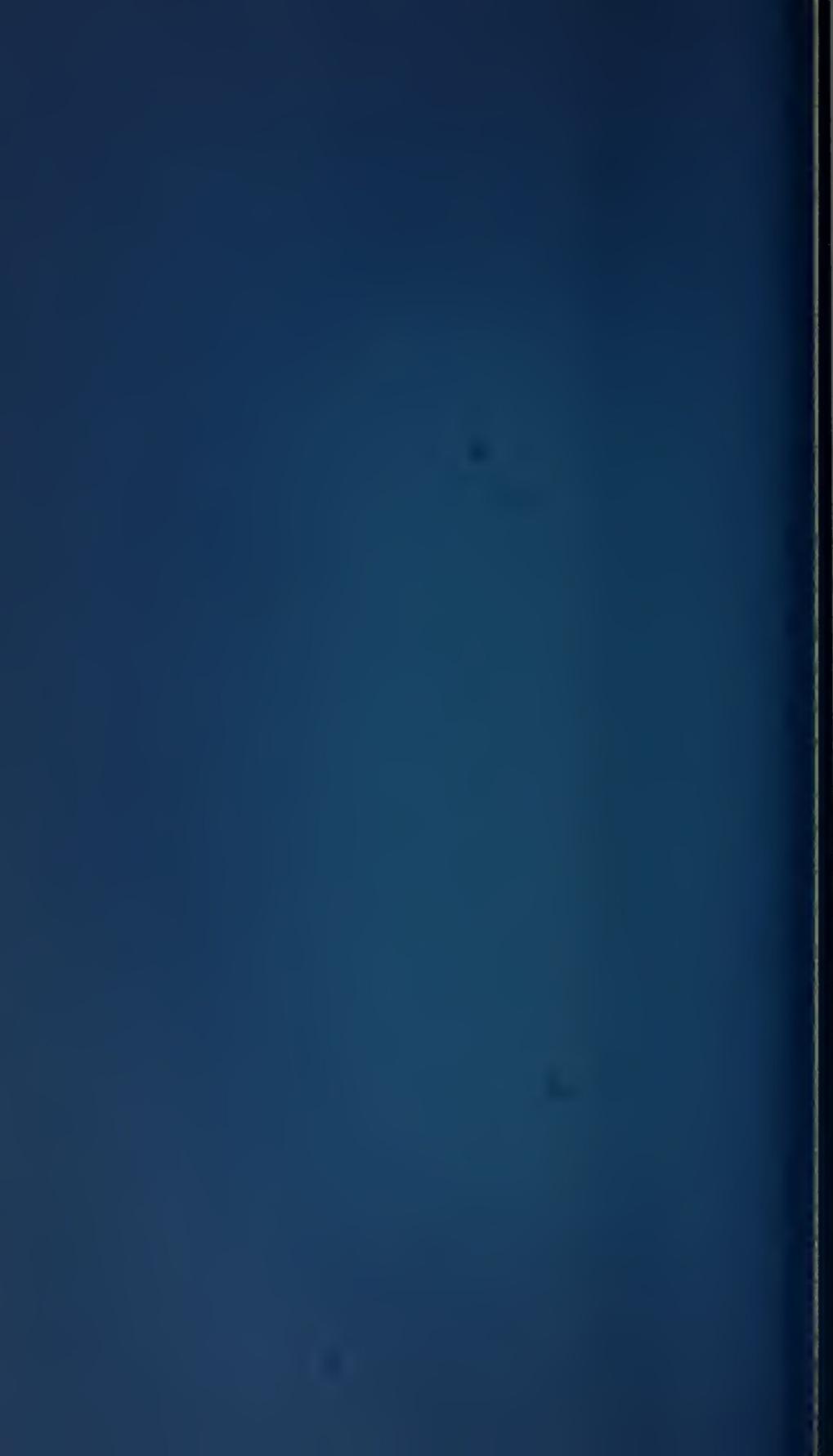
HARGRAVE A. GARRISON,

*Attorneys for Appellants.*

(Appendix Follows.)







## **Appendix**

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### **TREASURY REGULATIONS 111, SEC. 29.23(o)-1, PERTAINING TO INDIVIDUALS (1939 REVENUE CODE).**

(The Regulation as it existed during the tax year involved in the *Cammarano* case — 1948)

“Sec. 29.23(o)-1. Contributions or gifts by individuals.—

A deduction is allowable under section 23(o) only with respect to contributions or gifts which are actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books and records. A deduction is not allowable, however, for the actual payment of a contribution or gift if the amount of such payment already has been deducted on the accrual basis in computing net income for any taxable year beginning before January 1, 1938. A contribution or gift to an organization described in section 23(o) is deductible even though some portion of the funds of such organization is or may be used in foreign countries for charitable and educational purposes. This section does not apply to contributions or gifts by estates and trusts (see section 162). For computation of deductions for charitable contributions where the taxpayer also has an allowable deduction for medical expenses, see section 29.23(x)-1.

A contribution or gift to the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any possession of the

United States exclusively for public purposes, is deductible.

No reduction is allowed in computing the net income of a common trust fund or a partnership for contributions or gifts made to organizations described in section 23(o). (See sections 169 and 183.) However, a partner's proportionate share of contributions or gifts actually paid by a partnership during its taxable year to such organizations may be allowed as a deduction in his individual personal return for his taxable year with or within which the taxable year of the partnership ends, to an amount which, when added to the amount of contributions made by the partner individually and claimed as a deduction, is not in excess of 15 percent of his adjusted gross income or, for taxable years beginning prior to January 1, 1944, 15 percent of his net income computed without the benefit of the deduction for contributions. In the case of a nonresident alien individual or a citizen of the United States entitled to the benefits of section 251, see sections 213(c) and 251. For contributions or gifts by corporations, see section 29.23(q)-1.

In the case of husband and wife making a joint return, the deduction for contributions or gifts is the aggregate of such contributions or gifts made by the spouses, and is limited to 15 percent of the aggregate adjusted gross income of the spouses or, for taxable years beginning prior to January 1, 1944, 15 percent of the aggregate net income of the spouses computed without the benefit of the deduction for contributions.

A donation made by an individual to an organization other than one referred to in section 23(o) which bears a direct relationship to his business and is made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute an allowable deduction as business expense.

*Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.*

If the contribution or gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the contribution or gift.

In connection with claims for deductions under section 23(o), there shall be stated in returns of income the name and address of each organization to which a contribution or gift was made and the amount and the approximate date of the actual payment of the contribution or gift in each case. Claims for deductions under section 23(o) must be substantiated, when required by the Commissioner, by a statement from the organization to which the contribution or gift was made showing whether the organization is a domestic organization, the name and address of the contributor or donor, the amount of the contribution or gift and the date of the actual payment thereof, and by such other information as the Commissioner may deem necessary.” (italics ours)

(The provision relating to lobbying expenditures was first inserted in the Regulation in 1938 and at that time the Regulation was indexed and captioned "Art. 23(o)-1. Contributions or gifts by individuals". The reference to "23(o)" was to Sec. 23(o) of the Code, entitled "Charitable and other contributions" and providing for the deduction of charitable contributions by individuals (previously the Regulation had been indexed under "Sec. 23(n)", the predecessor of Sec. 23(o). The Regulation thereafter continued to bear the same caption and the same index: "23(o)-1".)

TREASURY REGULATIONS 74, ART. 261 (INDEXED "SEC. 23(n)")  
PERTAINING TO INDIVIDUALS (1928 REVENUE CODE).

(The Regulation as it existed during the tax years involved in the *Textile* case—predecessor of Reg. 111, Sec. 29.23(o)-1 previously set forth)

"Art. 261. Contributions or gifts by individuals.— Contributions or gifts made within the taxable year by an individual are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income (including such payments), if made to or for the use of:

(a) The United States, the District of Columbia, or any State or Territory or political subdivision thereof, for exclusively public purposes;

(b) Any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, but only if no part of the net earnings inures to the benefit of any private shareholder or individual. (See article 527);

(c) The special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act of June 27, 1918;

(d) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings

inures to the benefit of any private shareholder or individual; or

(e) A fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

If, during the taxable year and each of the 10 preceding taxable years, the amount contributed in all the above cases combined plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years exceeds 90 per cent of the taxpayer's net income for each such year, as computed without the benefit of this article, the full amount of such contributions and gifts made within the taxable year is deductible. (See section 120)

In connection with claims for deductions under this article, there shall be stated on returns of income the name and address of each organization to which a gift was made and the approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the gift. His proportionate share of contributions made by a partnership may be claimed as a deduction in the personal return of a partner to an amount which, when added to the amount of contributions made by the partner indi-

vidually and claimed as a deduction, is not in excess of 15 per cent of the partner's net income computed without the benefit of the deduction for contributions. As to deduction of contributions by partnerships, see section 183 and article 901. In the case of a nonresident alien individual or a citizen of the United States entitled to the benefits of section 251, see sections 213(c) and 251 and articles 1051 and 11.33. This article does not apply to gifts by estates and trusts (see section 162 and article 862), nor does it apply to corporations."

**OPINION OF THE DISTRICT COURT**  
**(March 19, 1956).**

Boldt, District Judge:

Whatever doubt there may have been about the meaning and application of Treasury Regulation 111 §29.23(o)-1 when it was first adopted some twenty years ago, and for some time thereafter, there does not seem to be much room for doubt about it now in the light of all of the cited decisions construing and applying the regulation. *Textile Mills Corp. v. Commissioner*, 314 U.S. 326; *Old Mission P. Cement Co. v. Commissioner*, 69 F. 2d 676 (CA 9th); *Sunset Scavenger Co. v. Commissioner*, 83 F. 2d 948 (CA 9th); *Roberts Dairy Co. v. Commissioner*, 195 F. 2d 948 (CA 8th); *American Hardware & Eq. Co. v. Commissioner*, 202 F. 2d 126 (CA 4th); *Revere Racing Association v. Scanlon*, 137 Fed. Supp. 293 (D.C. Mass.).

This regulation has been held to have the force of law just as though it were a statute, and the regulation in brief says that sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

It will be observed that several different categories of expenses are referred to. Lobbying expense is one, sums expended for the promotion or defeat of legislation is another, the exploitation of propaganda is a separate category, and so on. Under the cases construing this language, particularly the Ninth Cir-

cuit case, *Sunset Scavenger Co. v. Commissioner*, supra, the meaning of the regulation as applied to the facts of this case is clear. In Webster's International Dictionary and in "Words and Phrases," the meaning of the word "legislation" is given as having to do with the making of laws, however made. There are many decisions to such effect. In other words, the making of laws is legislation whether the laws are made by a sovereign ruler, a city council, county commissioners, a state legislature, Congress, or by the people directly through an initiative or referendum measure.

In applying the regulation there is no rational basis for making a distinction between sums of money spent for the purpose of influencing the public in their action on an initiative measure and sums spent with the object of influencing members of the legislature with respect to pending legislation. There certainly is not any ground for making that distinction in the language of the Treasury regulation. The regulation flatly says that sums of money expended for the promotion or defeat of legislation are not deductible from gross income. An initiative measure is just as much legislation as an act of a legislature or any other enactment of law.

It is admitted in the record that the sums here in question were spent by the taxpayer for the purpose of defeating the enactment of certain legislation by initiative and that being so, those sums are not deductible from gross income. This is not to indicate

that there is anything evil or corrupt about spending money for these purposes. Quite the contrary. The expenditure of money to enlighten and inform the public with respect of initiative measures is a perfectly proper and laudable activity. When the general public are called upon to enact or refuse to enact legislation, the more information they are given and the more widespread it is distributed the better. Certainly neither this taxpayer nor the Washington Brewers Institute nor the brewing industry are in any manner to be criticized for having spent the money to defeat the legislation by fair publicity. They had a right to do that and propriety of expenditures therefor is not in question. But that has nothing whatever to do with whether the sums so spent by the taxpayer are deductible for income tax purposes. In that matter the regulation is controlling and clearly requires judgment in favor of defendant. So ordered.

George H. Boldt,

United States District Judge.

IN THE  
United States Court of Appeals  
For the Ninth Circuit

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William B. CAMPARANO and LOUISE CAMPARANO,  
His Wife, Appellants

v.

UNITED STATES OF AMERICA, Appellee

---

On Appeal from the Judgment of the United States District  
Court for the Western District of Washington

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BRIEF FOR THE APPELLEE

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CHARLES K. RICE,  
*Assistant Attorney General.*  
ELLIS N. SLACK,  
HILBERT P. ZARKY,  
KARL SCHMEDOLFR,  
*Attorneys,*  
*Department of Justice,*  
*Washington 25, D. C.*

GEORGE P. MORLARTY,  
*United States Attorney.*

JOHN A. DOVETT,  
*Assistant United States Attorney.*

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IN THE  
United States Court of Appeals  
For the Ninth Circuit

---

No. 15,350

---

WILLIAM B. CAMMARANO and LOUISE CAMMARANO,  
His Wife, *Appellants*

v.

UNITED STATES OF AMERICA, *Appellee*

---

On Appeal from the Judgment of the United States District  
Court for the Western District of Washington

---

**BRIEF FOR THE APPELLEE**

---

**OPINION BELOW**

The oral decision of the District Court (R. 27-30) is not officially reported.

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**JURISDICTION**

This appeal involves federal income taxes for the year 1948. The taxes in dispute, \$153.58, were paid on October 16, 1951. (R. 20-21.) A claim for refund was filed on December 29, 1951. (R. 11-12, 21.) No

action having been taken on the claim (R. 21) within the time provided in Section 3772 of the Internal Revenue Code of 1939, and on March 15, 1955, taxpayers brought an action in the United States District Court for the Western District of Washington for recovery of the taxes paid. (R. 3-12.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The oral decision of the District Court was entered on March 28, 1956. (R. 27-30, 127.) The findings of fact, conclusions of law and judgment of the District Court were entered on July 30, 1956. (R. 43-50, 127.) On September 6, 1956, taxpayers filed a notice of appeal. (R. 51.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1291.

#### **QUESTION PRESENTED**

Whether the District Court was correct in disallowing a deduction to taxpayers under Section 23(a)(1) (A) of the Internal Revenue Code of 1939, for the amounts paid by taxpayers to a special fund to finance a publicity program to influence the voters of the State of Washington to vote to defeat an Initiative which would have prohibited the retail sale of beer and wine by any person other than the State of Washington.

#### **STATUTE AND REGULATIONS INVOLVED**

Internal Revenue Code of 1939:

##### **SEC. 23. DEDUCTIONS FROM GROSS INCOME.**

In computing net income there shall be allowed as deductions:

(a) [As amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, \* \* \*.

\* \* \* \* \*

(26 U.S.C. 1952 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.23(o)-1. *Contributions or Gifts by Individuals.*— \* \* \*

\* \* \* \* \*

Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

\* \* \* \* \*

### **STATEMENT**

The relevant facts as found by the District Court (R. 44-47) may be summarized as follows:

Taxpayers were husband and wife and filed a joint income tax return for the year 1948. They owned a one-quarter interest in a partnership carrying on wholesale distribution of beer under the trade name "Cammarano Brothers" in Tacoma, Washington. (R. 44-45.)

During 1948, the partnership paid \$3,545.15 to the Washington Beer Wholesalers Association, Inc., Trust Fund, taxpayers' proportionate share of such payment being \$886.29. The trust fund had been established on December 17, 1947, by the association of

which the partnership was a member, to help finance a state-wide publicity program on the part of wholesale beer and wine dealers. (R. 45.)

This publicity program urged the defeat of Initiative to the Legislature No. 13, which was submitted to the people of Washington in accordance with the legislation provisions of the State Constitution at the general election on November 2, 1948. The Initiative would have placed the retail sale of wine and beer exclusively in state owned and operated stores. The ballot title of the Initiative was as follows (R. 45):

An Act prohibiting the retail sale of beer and wine by any person other than the State of Washington, repealing all provisions of existing law pertaining to licensing of retail sale of beer and wine, revoking existing licenses and providing penalties.

The measure had previously been submitted to the state legislature. An officer of the Beer Wholesalers Association kept close track of its progress, and personally contacted many of the legislators and urged its defeat. The legislature did not act on the measure. (R. 45-46.)

With the measure going before the people, the wholesale and retail wine and beer dealers decided to undertake a vast publicity program aimed at the people who were to vote on the measure in November, 1948. It was decided that the program should be directed by a committee made up from the various groups and associations interested in defeat of the measure, and financed by contributions from those groups and associations and other interested parties. An Industry Advisory Committee was established to direct the program, in support of which it was furnished with \$231,257.10. Of

that amount, \$53,500 came from the Beer Wholesalers Association, which collected the money by assessing its members amounts based upon their volume of business. The collections were handled by the association through a trust fund, which was established as a separate entity to receive and disburse the assessments. The program was carried out by various types of advertising. None of this advertising had reference to the wares or members of the association as such. (R. 46.)

There was testimony to the effect that the Initiative, if passed, would have affected the wholesale business of Cammarano Brothers. However, the way in which the measure, aimed as it was at retail sales of wine and beer, would have affected the wholesale distribution of beer was not made clear. In any event, the measure was defeated. (R. 46.)

As early as September 3, 1937, the Commissioner ruled that the Beer Wholesalers Association was exempt from federal income tax. During the period of the publicity program the association continued its usual activities and collected its usual dues from its members, including Cammarano Brothers. (R. 47.)

The District Court found that the payment made to the trust fund by Cammarano Brothers was entirely for propaganda and aimed at the defeat of legislation, and therefore was not deductible under Section 23(a)(1)(A) of the Internal Revenue Code of 1939, as an "ordinary and necessary expense paid or incurred during the taxable year in carrying on" its business of the wholesale distribution of beer. (R. 47-48.)

## SUMMARY OF ARGUMENT

The Internal Revenue Code of 1939 does not allow a deduction for all expenses paid or incurred by a business. Section 23(a)(1)(A) of the 1939 Code permits a deduction for "ordinary and necessary expenses" incurred "in carrying on any trade or business \* \* \*." Section 29.23(o)-1 of Treasury Regulations 111, promulgated under the 1939 Code prohibits the deduction of "sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses \* \* \*."

The regulation uniformly has been held to apply to Section 23(a)(1)(A) of the statute and to be a valid limitation upon what items may be deducted as "ordinary and necessary" expenses of "carrying on" a business. Furthermore, it is well recognized that the regulation is not limited only to expenses of lobbying before a legislature, for the regulation applies as well to publicity campaigns directed at voters who are to vote on a measure. Additionally, it is recognized that it is immaterial whether such lobbying, or the promotion or defeat of legislation, or propaganda, etc., is against "public policy" for the regulation applies to all attempts to influence the promotion or defeat of legislation.

Thus, in the present case, where taxpayers expended sums upon advertising, etc., to persuade the voters to defeat an Initiative, the sums were expended for the "defeat of legislation" and for "advertising other than trade advertising" within the meaning of the regulation, and a deduction for such amounts was properly denied by the District Court.

## ARGUMENT

The District Court Was Correct in Holding That Amounts Expended to Influence Voters to Defeat an Initiative Which Would Have Prohibited the Retail Sale of Beer and Wine by Any Person Other Than the State of Washington Did Not Constitute an Ordinary and Necessary Expense Incurred in Carrying on Taxpayers' Business of the Wholesale Distribution of Beer Under Section 23(a)(1)(A) of the Internal Revenue Code of 1939 and Section 29.23(o)-1 of Treasury Regulations 111

This case concerns the applicability of Section 23(a)(1)(A) of the Internal Revenue Code of 1939, *supra*, and of Section 29.23(o)-1 of Treasury Regulations 111, *supra*, promulgated under the 1939 Code.

During 1948, the partnership, Cammarano Brothers, in which taxpayers had a 25 per cent interest, paid \$3,545.15 to the Washington Beer Wholesalers Association, Inc., Trust Fund to help finance an extensive statewide publicity program to influence the voters of the State of Washington to defeat Initiative 13 at the general election on November 2, 1948. This Initiative would have placed the retail sale of wine and beer exclusively in state-owned and operated stores. An industry Advisory Committee was established to direct the program to defeat the Initiative, in support of which it was furnished with \$231,257.10. Of this amount, \$53,500 came from the Beer Wholesalers Association, which collected its share of the money by assessing its members amounts based upon their volume of business. The Industry Advisory Committee spent the money received by it primarily on advertising, and also for printing, public relations expenses, etc. (R. 21-23, 45-46, 79, 82-84, 103-107, 112-116, Exs. 7, B. E.)

Taxpayers seek to deduct their aliquot share of the amount which Cammarano Brothers paid to the Beer Wholesalers Association as an ordinary and neces-

sary business expense of the partnership under Section 23(a)(1)(A) of the 1939 Code. The District Court held (R. 47-48) that the payment "was entirely for propaganda" and was "aimed at the defeat of legislation", and accordingly was not deductible as an "ordinary and necessary" trade or business expense under Section 23(a)(1)(A).

The relevant portion of Section 23(a)(1)(A) is as follows:

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business,  
\* \* \*.

\*       \*       \*       \*

The provisions of Section 29.23(o)-1 of Treasury Regulations 111, which control taxpayers' right to a deduction, are as follows:

Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

The court decisions which have construed these provisions have uniformly held that sums of money spent for lobbying, for the promotion or defeat of legislation, for campaign purposes, etc., and which are similar to the payments made in the present case do not constitute the ordinary and necessary expenses of carry-

ing on a trade or business and, accordingly, are not deductible under Section 23(a)(1)(A). *Textiles Mills Corp. v. Commissioner*, 314 U.S. 326; *McDonald v. Commissioner*, 323 U.S. 57; *Sunset Scavenger Co. v. Commissioner*, 84 F. 2d 453 (C.A. 9th); *Old Mission P. Cement Co. v. Commissioner*, 69 F. 2d 676 (C.A. 9th); *Revere Racing Assn. v. Scanlon*, 232 F. 2d 816 (C.A. 1st); *American Hardware & Eq. Co. v. Commissioner*, 202 F. 2d 126 (C.A. 4th); certiorari denied, 346 U.S. 814; *Roberts Dairy Co. v. Commissioner*, 195 F. 2d 948 (C.A. 8th), certiorari denied, 344 U.S. 865; *Mays v. Bowers*, 201 F. 2d 401 (C.A. 4th), certiorari denied, 345 U.S. 969; *Davis v. Commissioner*, 26 T.C. 49; *McClintock-Trunkey Co. v. Commissioner*, 19 T.C. 297, reversed on another issue, 217 F. 2d 329 (C.A. 9th); *Wm. T. Stover Co. v. Commissioner*, 27 T.C. No. 48; *Bellingrath v. Commissioner*, 46 B.T.A. 89; *Cullen v. Commissioner*, 41 B.T.A. 1054; *Kyne v. Commissioner*, 35 B.T.A. 202; *Mosby Hotel Co. v. Commissioner*, decided October 22, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,288).

At the outset, taxpayers question (Br. 11-22) whether this prohibition contained in Section 29.23(o)-1 of the Regulations is applicable to Section 23(a)(1)(A) of the statute. Taxpayers attempt to make much of the fact that the predecessor of Section 29.23(o)-1 is entitled "Donations" and deals in large part with charitable contributions by individuals, whereas Section 23(a)(1)(A) is concerned with deductions for business expenses.

Such contentions, however, are conclusively answered by the following decisions, which hold, in response to direct attacks on the applicability of the prohibition in the Regulations to the business expense

provision of the statute, that it is applicable. *Textile Mills Corp. v. Commissioner, supra; Sunset Scavenger Co. v. Commissioner, supra; American Hardware & Eq. Co. v. Commissioner, supra; Revere Racing Assn. v. Scanlon, supra; McClintock-Trunkey Co. v. Commissioner, supra; Bellingrath v. Commissioner, supra.* As the Supreme Court has stated in *Textile Mills Corp. v. Commissioner, supra* (pp. 337-338):

If this is a valid and applicable regulation, the sums in question were not deductible as "ordinary and necessary expenses" under § 23 (a), since they clearly run afoul of the prohibition in the last sentence of the regulation.

Plainly, the regulation was applicable. The ban against deductions of amounts spent for "lobbying" as "ordinary and necessary" expenses of a corporation derived from a Treasury Decision in 1915. T.D. 2137, 17 Treas. Dec., Int. Rev., pp. 48, 57-58. That prohibition was carried into Art. 143 of Treasury Regulations 33 (Revised, 1918) under the heading of "Expenses" in the section on "Deductions." Beginning in 1921 the regulation was entitled "Donations." (Art. 562, Treasury Regulations 45.) And in the regulations here in question Art. 262 appeared under § 23 (n), which covered "Charitable and other contributions" by individuals. It assumed that form and content in 1921 and appeared since then without change in all successive regulations. Sec. 23 (n) and § 23 (a) both deal with deductions; and a "donation" by a corporation though not deductible under the former might be under the latter. Art. 262 purports to specify when a certain type of expenditure or donation by a corporation may or may not be deducted as an "ordinary and necessary" expense. The argument that it was not

applicable because it was not specifically incorporated under § 23 (a) is frivolous.<sup>1</sup>

<sup>1</sup> From almost the inception of the present income tax law, the Treasury has continuously and unambiguously ruled that amounts spent for "lobbying" and for "the promotion or defeat of legislation" are not ordinary and necessary business expenses. The first published ruling appeared in T.D. 2137, 17 Treasury Decisions 48, 57-58 (1915), which declared that "Sums of money expended for lobbying purposes and contributions for campaign expenses are held not to be an ordinary and necessary expense in the *operation and maintenance* of the business of a corporation, and are, therefore, not deductible from gross income in arriving at the net income upon which the income tax is computed." (Emphasis supplied.) This determination, elaborated to refer expressly to expenditures for "the promotion or defeat of legislation," was incorporated as Article 143 of Treasury Regulations 33 (1918 ed.), wherein it was indicated that this was an interpretation of the phrase "ordinary and necessary." The regulation assumed its present form in Article 562 of Treasury Regulations 45 (1919 ed.), promulgated under the Revenue Act of 1918, and has since appeared without change, in all successive Regulations. See Article 562 of Treasury Regulations 45 (1920 ed.), 62, 65 and 69, promulgated under the Revenue Acts of 1918, 1921, 1924, and 1926, Article 262 of Treasury Regulations 74 and 77 (1929 and 1937 eds.), promulgated under the Revenue Acts of 1928 and 1932, Article 23(o)-2 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, Article 23(q)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, Article 23(o)-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, Sections 19.23(o)-1, 29.23(o)-1 and 39.23(o)-1 of Treasury Regulations 103, 111 and 118, respectively, promulgated under the Internal Revenue Code of 1939, and Section 1.162-15 of the proposed Income Tax Regulations under the Internal Revenue Code of 1954.

As pointed out, *supra*, both T.D. 2137, and Article 143 of Treasury Regulations 33 (1918 ed.), were an interpretation of the phrase "ordinary and necessary", and both incorporated the prohibition under provisions labelled "Lobbying Expenses". Beginning with Treasury Regulations 45 (1919 ed.), this provision was incorporated for reasons of convenience in the article relating to corporate deductions, entitled "Donations". Prior to 1928,

Taxpayers contend, in effect (Br. 45-47), that the Supreme Court in *Textile Mills, supra*, relied upon the fact that the trade or business expense provision "was the only possible section under which the Regulation relating to corporations could fall" in holding that the Regulations were applicable to Section 23(a)(1) (A); that the statute subsequently was amended to permit corporations to deduct for donations; and that the retention of the prohibition in the provision of the regulations relating to corporate donations showed an intent that the Regulations should not be applicable in the future to Section 23(a)(1)(A) of the statute. Such a contention is not well founded. This, plainly, is only a repetition of the argument made in *Textile Mills*. As previously pointed out (fn. 1, *supra*), prior

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there were separate provisions in the Revenue Acts dealing with expenses allowable to individuals and expenses allowable to corporations, although the provisions were identical. Moreover, these early Revenue Acts provided for deductions to individuals for charitable contributions, but made no similar provision for corporations. However, it was recognized that such donations might, under some circumstances, qualify as "ordinary and necessary" business expenses of a corporation. Accordingly, there appeared in the Regulations, under the statutory provisions relating to corporate donations, an article indicating when such donations were deductible as expenses. Since lobbying and other similar expenses were thought to be loosely related to donations, the provisions dealing therewith were likewise incorporated in the same article. It should be noted that this prohibition was not included during these many years in the articles of the Regulations dealing with charitable donations by individuals, although the articles dealing with individuals did refer to the articles relating to corporate donations. Thus, it is clear that the Regulations spelled out when such expenditures might or might not be deductible as "ordinary and necessary" business expenses.

In 1928, the structure of the revenue statute was simplified, and expense deductions for corporations and individuals were incorporated in a single section, namely, Section 23(a). Under the

to the decision in *Textile Mills* the prohibition could have been placed in the section of the Regulations dealing with trade or business expenses, but the Supreme Court held that an argument based upon the Commissioner's failure to have made such a placement was frivolous. There is no indication that the continued retention of the prohibition in the section of the Regulations relating to corporate donations after Section 23 (q) of the statute was enacted was for reasons other than convenience. The failure to repeat the prohibition in every subsection of the Regulations under which a deduction might be claimed is of no more weight here than it was in *Textile Mills*. *American Hardware & Eq. Co. v. Commissioner, supra*, pp. 129-130.

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reorganized structure, charitable contributions by individuals were dealt with in Section 23(n). However, no similar provision for corporations was enacted until Section 102(c) of the Revenue Act of 1935, c. 829, 49 Stat. 1014, which added Section 23(r) to the Revenue Act of 1934, c. 277, 48 Stat. 680 (later changed to Section 23(q) of the Revenue Act of 1936, c. 690, 49 Stat. 1648). For functional reasons, it was considered to be more desirable to continue thereafter the prohibition against these deductions in the regulatory provisions dealing with corporate donations. Although the provision relating to the deductibility of donations by individuals had existed in the Regulations for many years a similar prohibition was not included in the provisions of the Regulations dealing with individuals until 1939, and then by Article 23(o)-1 of Treasury Regulations 101. Thus, it is clear from the origin of these provisions, as well as from their content, that they are concerned with the question whether expenditures for lobbying purposes, the promotion or defeat of legislation, etc, are deductible as "ordinary and necessary" business expenses. This is further shown by the fact that in the proposed Income Tax Regulations under the 1954 Code this prohibition is contained in Section 1.162-15, which is placed under Section 162, dealing with trade or business expenses, rather than under Section 170, dealing with charitable and other contributions by individuals and corporations.

Taxpayers' contention (Br. 23-34, 37-42), that Section 29.23(o)-1 is invalid to the extent that it seeks to limit the deduction of certain expenditures as "ordinary and necessary" expenses of a trade or business under Section 23(a)(1)(A) of the 1939 Code, likewise lacks substance. This provision of the regulation has authoritatively been held valid. The general principle that repeated congressional reenactment of the statutory provision to which a regulation pertains, here Section 23(a)(1)(A) of the 1939 Code, gives to the Regulations the force of law (*Helvering v. Winmill*, 305 U.S. 79, 83; *Commissioner v. Flowers*, 326 U.S. 465, 469; *Boehm v. Commissioner*, 326 U.S. 287, 291-292), has been repeatedly applied to this particular provision in answer to direct challenges as to its validity (*Textile Mills Corp. v. Commissioner*, *supra*, pp. 338-339; *Sunset Scavenger Co. v. Commissioner*, *supra*, p. 456; *Roberts Dairy Co. v. Commissioner*, *supra*, p. 950; *American Hardware & Eq. Co. v. Commissioner*, *supra*, pp. 129-130; see *Commissioner v. Heininger*, 320 U.S. 467, 470; *Lilly v. Commissioner*, 343 U.S. 90, 95). The Supreme Court has stated in *Textile Mills Corp. v. Commissioner*, *supra* (pp. 338-339):

Petitioner's argument that the regulation is invalid likewise lacks substance. The words "ordinary and necessary" are not so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation. The numerous cases which have come to this Court on that issue bear witness to that. *Welch v. Helvering*, 290 U.S. 111; *Deputy v. du Pont* 308 U.S. 488, and cases cited. Nor has the administrative agency usurped the legislative function by carving out this special group of expenses and making them non-deductible. We fail to find

any indication that such a course contravened any Congressional policy. Contracts to spread such insidious influences through legislative halls have long been condemned. *Trist v. Child*, 21 Wall. 441; *Hazelton v. Sheckells*, 202 U.S. 71. Whether the precise arrangement here in question would violate the rule of those cases is not material. The point is that the general policy indicated by those cases need not be disregarded by the rule-making authority in its segregation of non-deductible expenses. There is no reason why, in absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction. The exclusion of the latter from "ordinary and necessary" expenses certainly does no violence to the statutory language. The general policy being clear it is not for us to say that the line was too strictly drawn.<sup>2</sup>

The two Supreme Court decisions most relevant to the present proceedings are *Textile Mills Corp. v. Commissioner*, *supra*, and *McDonald v. Commissioner*, 323 U.S. 57. In *Textile Mills* taxpayer, among other activities, acted on behalf of certain German textile companies to endeavor to obtain legislation providing for the return of German property seized during

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<sup>2</sup> There does not appear to be any basis for taxpayers' contention (Br. 32-34) that "the theory of statutory re-enactment cannot be invoked" here because the regulation was not captioned under Section 23(a)(1)(A). As pointed out, *supra*, the Regulations repeatedly had been held applicable to Section 23(a)(1)(A). Furthermore, it is difficult to conceive that Congress was not aware of a regulation which for almost forty years prohibited the deduction for expenditures for, among other things, promotion or defeat of legislation and for campaign expenses.

World War I under the Trading with the Enemy Act. As brought out in the opinion of the Court of Appeals for the Third Circuit (117 F. 2d 62),<sup>3</sup> taxpayer employed a publicity firm to prepare news items, speeches, and editorial comment. It also employed an attorney, a former Congressman, to deal with members of Congress, and two attorneys, former government officials, to prepare a brochure setting out the legal questions involved in the wartime seizure of private property. At issue was the deductibility of the payments to the publicity firm and to the two latter attorneys. It did not appear that either the firm or these attorneys dealt directly with Congress. The expenditures were held nondeductible, the Court relying upon the regulation as prohibiting the deduction.

The *McDonald* decision denied the deductibility of campaign expenses incurred by a judge appointed to a vacancy who was running for election for a full term. The opinion of the Court (323 U.S. 57, 60, 62) refers to the principle of *New Colonial Co. v. Helvering*, 292 U.S. 435, that deductions are matters of legislative grace, and to "the disallowance of campaign expenses as consistently reflected by legislative history, court decision, Treasury practice and Treasury Regulations." Furthermore, the decision drew a distinction between the expenses "related to the discharge of his functions as a judge" which were deductible, and his campaign expenditures which "were not expenses incurred in being a judge but in trying to be a judge for the next ten years." It referred to "the explicit restrictions of § 23 confining deductible expenses solely

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<sup>3</sup> Taxpayer's statement in the present case (Br.44), that the Supreme Court reversed the Third Circuit in *Textile Mills*, is incorrect. Both Courts held the expenditures not to be deductible.

to outlays in the efforts or services—here the business of judging—from which the income flows.” Finally, it stated that “To draw a distinction between outlays for re-election and those for election—to allow the former and disallow the latter—is unsupportable in reason.” McDonald was unsuccessful in his campaign. *Mays v. Bowers, supra*, applied its reasoning to deny a deduction for expenses incurred in a successful campaign.

In *Sunset Scavenger Co. v. Commissioner, supra*, this Court denied a deduction for expenditures for pamphlets, newspaper advertisements, speakers, all of which were addressed to the public and were designed to avert the passage by the voters of a proposed ordinance which would have injured the business of garbage collection. The Court stated that the regulation prohibited the deduction. See also *Old Mission P. Cement Co. v. Commissioner, supra*, wherein this Court also denied a deduction for contributions to a fund to promote a state-wide referendum for an increased gasoline sales tax levy. The referendum was successful; road construction increased; and taxpayer shared in the increased sales of cement. Nevertheless, its expenditure was held to be for lobbying and therefore nondeductible.

In *Revere Racing Assn. v. Scanlon, supra*, taxpayer operated a greyhound race track under license, and expended sums for promotional advertising, public relations and legal fees to help persuade a majority of the voters of Suffolk County to vote to approve the continued licensing of dog races in that county. The First Circuit held that the sums expended were not ordinary and necessary expenses paid in carrying on any trade or business, i.e., the expenses of doing busi-

ness, but were to put the voters in a frame of mind that would give taxpayer a possible opportunity to do business later. Additionally, that court held that a deduction should be denied by Section 29.23(q)-1 of Treasury Regulations 111, which is identical here to Section 29.23(o)-1. "Although taxpayer's expenditures were made to influence voters rather than members of the legislation", the First Circuit held that such expenditures "come within the prohibition of the regulation," citing *Textile Mills*.

Contrary to the contention raised by taxpayers (Br. 42-58, 66-67, 74-75), the regulation is not limited to those expenditures which are improper, corrupt, or against "public policy", nor only to those where direct pressure is brought upon a legislature. Taxpayers would, in effect, narrowly construe each of the clauses of the regulation, limiting its application solely to lobbying; construing the term, lobbying, solely to appearances before a representative body; limiting the promotion or defeat of legislation to that enacted by a representative body; limiting the term propaganda to insidious propaganda; and limiting campaign expenses to those of running for office. Such a narrow construction is, as the District Court below held (R. 28-30), not supported by the regulation, by the relevant decisions or by the fundamental principles involved. Instead, the cases hold that the regulation prohibits a deduction for any of the listed items, regardless of whether the expenditure is considered to be against some conceived "public policy". Additionally, the cases hold that the regulation applies to an expenditure made to influence the voters, as well as to one made to influence legislators. Any other construction would be

senseless, particularly where, as here, the voters act as legislators.

The plain language of Section 29.23(o)-1 applies not only to deductions for expenses of lobbying, but it applies with equal force to amounts expended for the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and to contributions for campaign expenses. Furthermore, there is not any qualification in the regulation that only amounts which (Br. 42) "violate sharply defined national and state policies" should be disallowed. Instead, it appears that the regulation was not intended to differentiate between *good* or *evil* lobbying, *good* or *evil* propaganda, as is shown by its language which flatly prohibits a deduction for amounts expended for lobbying, for promoting or defeating legislation, or for the exploitation of propaganda. Additionally, the language of the regulation on its face, applies equally to expenditures to influence voters, as well as to members of a legislature.

Taxpayers rely (Br. 47-50) upon language in *Textile Mills* to support their contention that the Court there was prohibiting expenditures only for "contracts unenforceable on the ground of public policy" and only to amounts spent for "lobbying" before a legislature. However, it should be noted that the deductions which were disallowed related only to amounts expended for news items, speeches, editorial comment, and for a brochure setting out the legal questions involved in the wartime seizure of private property, and did not relate to the matters which the Supreme Court condemned as against public policy. Furthermore, it does not appear that the publicity firm or the two at-

torneys who prepared the brochure dealt directly with any legislature.

In *Sunset Scavenger Co. v. Commissioner*, *supra*, the advertisements, pamphlets, speakers, etc., for which the deduction was denied, were addressed to the public rather than to a legislature. Furthermore, it was not shown in that case that the expenses were contrary to any public policy. In *American Hardware & Eq. Co. v. Commissioner*, *supra*, p. 130, deductibility was denied to contributions to the National Tax Equality Association\$, organized to conduct educational, scientific and research activities relative to disparities in federal and estate tax statutes and to disseminate information to civic organizations, the public, and the federal and state governments. The ultimate objective of its propaganda was revision of the tax structure, principally to eliminate special tax benefits for cooperatives. In answer to an attack in that case upon the applicability of the *Textile Mills* decision to items of expense which were not against "public policy", the Fourth Circuit held (p. 130) that it found no substance—

in the additional objection that the decision in *Textile Mills Corp. v. Commissioner*, is limited to the non-deductibility of items which are against public policy or are morally wrong. Both of these objections are clearly untenable under that decision.

In *Roberts Dairy Co. v. Commissioner*, *supra*, p. 949, a contribution to the National Tax Equality Association was held nondeductible under the regulation although the association "did not engage in lobbying activities, had no congressmen on its mailing list and

lid not request to appear before congressional committees considering changes in tax statutes." In *Revere Racing Assn. v. Scanlon, supra*, expenditures, made to influence the voters of Suffolk County to vote favorably to permit the continued licensing of dog races, were clearly not against public policy. Furthermore, these expenditures were made to influence the voters and not a legislative body, which the First Circuit held came (p. 819) "within the prohibition of the regulation", citing *Textile Mills*. Thus, none of the applicable Court of Appeals decisions, have construed the opinion in *Textile Mills* as narrowly as is contended for by taxpayers, i.e., to limit the prohibition of the Regulations only to those expenditures which are against public policy or are made to influence a legislature.

In the present case, it cannot be disputed that the amounts here involved were expended for propaganda to defeat legislation—to persuade the voters of the State of Washington what should be the law as to the retail sale of wine and beer.

Initially, the provisions of Initiative 13 had been submitted to the state legislature. The legislature did not act on this measure. Thereafter, in accordance with Article II, Section 1(a) and 41 of the Constitution of the State of Washington, as amended by Amendments 7 and 26, the proposal was submitted to the voters of the state for approval or rejection. (R. 45-46.) If Initiative 13 had been approved by the voters, it would have become a law of the state and, subject to some restrictions, would have been subject to amendment or repeal thereafter by the state legislature. Under such circumstances, by approving or rejecting the Initiative, the voters were exercising legislative

powers with respect to substantive law of the state. *Senior Cit. L. v. Dept. Soc. Sec.*, 38 Wash. 2d 142, 152, 228 P. 2d 478. Thus, where taxpayers expended amounts admittedly for propaganda to defeat Initiative 13 (R. 77, 79, 80-84, 112-116) these amounts were clearly expended to defeat legislation within the meaning and intentment of the regulation.

The cases relied upon by taxpayers, such as *Commissioner v. Heininger*, 320 U.S. 467; *Lilly v. Commissioner*, 343 U.S. 90; and *United States v. Rumely*, 34 U.S. 41, are not applicable herein. As the Supreme Court points out in *Commissioner v. Heininger*, *supra*, p. 470, and in *Lilly v. Commissioner*, *supra*, p. 9, while upholding the validity of the Regulations which disallowed a deduction for lobbying expenses, the regulation was not applicable to those cases.

*Smith v. Commissioner*, 3 T.C. 696 (Acquiescence 1944 Cum. Bull. 26), decided prior to *Textile Mills*, held deductible contributions by a lawyer, in the belief it would help his practice, to the Missouri Institute for the Administration of Justice. The purpose was to secure an amendment to the state constitution to change the method of selecting certain judges. The Tax Court emphasized (p. 702) that there was no lobbying before the legislature itself, a ground for decision which lost its basis with the *Textile Mills* decision, and is inconsistent with later decisions of the Tax Court. For example, in *McClintock-Trunkey Co. v. Commissioner*, *supra*, contributions, among others, to the Washington Beer Wholesalers Association opposing the same proposed Initiative as is involved in the present case, were held nondeductible; in *Mosby Hotel Co. v. Commissioner*, *supra*, contributions to the Kansas Legal Control Council for an advertising

ampaign looking to repeal of the prohibition laws were held nondeductible; and in *Davis v. Commissioner, supra*, contributions to a liquor association to persuade the voters to vote in a referendum to allow the retail sale of liquor were also denied a deduction.

### CONCLUSION

For the reasons stated, the judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

CHARLES K. RICE,  
*Assistant Attorney General.*

ELLIS N. SLACK,  
HILBERT P. ZARKY,  
KARL SCHMEIDLER,  
*Attorneys,*  
*Department of Justice,*  
*Washington 25, D. C.*

CHARLES P. MORIARTY,  
*United States Attorney.*

JOHN A. B. DOVELL,  
*Assistant United States Attorney.*

April, 1957.



No. 15,350

IN THE

United States Court of Appeals  
For the Ninth Circuit

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WILLIAM B. CAMMARANO and LOUISE  
CAMMARANO, his wife,  
vs.  
*Appellants,*

UNITED STATES OF AMERICA,  
*Appellee.*

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REPLY BRIEF OF APPELLANTS.

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ATHEARN, CHANDLER & HOFFMAN,

WALTER HOFFMAN,

CLARK W. MASER,

Seventh Floor, Balboa Building,

San Francisco 5, California,

JONES & GREY,

A. R. KEHOE,

HARGRAVE A. GARRISON,

610 Colman Building, Seattle, Washington,

*Attorneys for Appellants.*

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PAUL P. O'BRIEN, CL



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*Appellee.*

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**REPLY BRIEF OF APPELLANTS.**

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In the same order in which Appellee has presented its contentions Appellants now reply.

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**CLARIFICATION OF STATEMENT OF FACTS.**

Preliminarily certain statements regarding the facts should be clarified.

The Washington Beer Wholesalers Association neither received nor paid out any funds expended in connection with the Initiative. All contributions were paid to a fund, separate and apart from the Association. Members and non-members of the Association

made contributions to the fund on the basis of the volume of business of each contributor. All disbursements in combatting the Initiative were made by an overall Industry Advisory Committee (TR. 77, 79, 84, 85, 86).

The fund was created for the specific purpose of combatting the Initiative voted upon by the People in November, 1948 and the fund was used solely for that purpose. The Washington State Legislature was not in session during 1948 (TR. 23, 45, 46).

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(1) REPLY TO CONTENTION: "THE COURT DECISIONS WHICH HAVE CONSTRUED THESE PROVISIONS HAVE UNIFORMLY HELD THAT SUMS OF MONEY SPENT . . . FOR THE PROMOTION OR DEFEAT OF LEGISLATION . . . AND WHICH ARE SIMILAR TO THE PAYMENTS MADE IN THE PRESENT CASE DO NOT CONSTITUTE THE ORDINARY AND NECESSARY EXPENSES OF CARRYING ON A TRADE OR BUSINESS . . ." (Appellee's Br. 8, 9).

The provisions referred to are the provisions of Section 23(a)(1)(A) and Treas. Reg. 111, Sec. 29.23(o)-1.

The following classification of all of the fifteen decisions cited by Appellee, shows that the expenditures involved in those decisions are not "similar to the payments made in the present case."

(a) Decisions where the payments did not pertain to carrying on an existing business but on the contrary related to a future business.

Expenditures incurred in: *McDonald v. Commissioner*, 323 U.S. 57, to be elected a Judge in the future;

*Revere Racing Assn. v. Scanlon*, 232 F. 2d 816 (C. A. 1st), to legalize dog racing for a future four year period; *Mays v. Bowers*, 201 F. 2d 401 (C. A. 4th), to be elected a City Councilman; *Davis v. Commissioner*, 26 T.C. 49, to legalize the sale of liquor for a future two year period; *Kyne v. Commissioner*, 35 B.T.A. 202, to legalize horse racing in the future; *Mosby Hotel Co. v. Commissioner*, 1954 P-H T.C. Memorandum Decisions, par. 54,288 (13 T.C.M. 996), to legalize the future sale of liquor and in addition for lobbying.

In contrast to the foregoing cases, taxpayers here were in an existing business with the right to continue in same indefinitely and were not dependent upon a vote of the electorate for the future commencement of their business or for the right to engage in business in the future after expiration of a fixed term. The expenditures were incurred in defending and carrying on an existing business and not a future business precisely in the same manner that the mail order dentist in *Commissioner v. Heininger*, 320 U.S. 467 incurred expenditures in defending his business—there an assault against his business by the Postmaster General—here an assault against taxpayers' business by the proponents of the Initiative.

(b) Decisions involving public policy.

In *Textile Mills Sec. Corp. v. Commissioner*, 314 U.S. 326, the expenditures were of a certain type for "lobbying" in "legislative halls" and so characterized by the Court in its opinion and in two subsequent Supreme Court decisions, *Commissioner v. Heininger*, supra,

and *Lilly v. Commissioner*, 343 U.S. 90; *American Hardware & Eq. Co. v. Commissioner*, 202 F. 2d 126 (C. A. 4th) and *Roberts Dairy Co. v. Commissioner*, 195 F. 2d 948 (C. A. 8th), involved expenditures incurred in connection with legislation pending in "legislative halls" (i.e.: Congress); *Bellingrath v. Commissioner*, 46 B.T.A. 89, involved expenditures in furtherance of "lobbying" before the legislature of Alabama; in *Cullen v. Commissioner*, 41 B.T.A. 1054, taxpayers paid a sum of money to a Committee to uphold taxpayers' right to file separate Federal income tax returns under the community property laws of Texas and another sum to oppose Federal legislation giving the Secretary of the Interior broader powers over all the oil industry in Texas. With respect to the first item, the Court held the expenditures were purely personal and not connected with any business. With respect to the second item the expenditures were incurred in connection with legislation pending in "legislative halls" (i.e.: Congress) and additionally the Court held the expenditures were "too remote"; in *McClintock-Trunkey Co. v. Commissioner*, 19 T.C. 297, taxpayer paid a total of \$190.00 in dues to three associations: the Washington Beer Wholesalers Association, Taxpayers' League and Good Roads Association. The Good Roads Association and the Taxpayers' League were admittedly active in sponsoring legislation in the Washington legislature. The Washington Beer Wholesalers Association was active in opposing the Initiative. The amount of dues paid to each association was not specified and the

Court treated the \$190.00 so paid *collectively as a single expenditure*. The Court held that a substantial part of the activities of the three organizations might *collectively* be regarded as lobbying and hence denied a deduction on the ground of the Regulation. Taxpayer under such circumstances simply failed to meet the burden of proof in showing what portion of the \$190.00 so collectively expended was not for lobbying and in any event failed to affirmatively show that the expenditures were "ordinary and necessary". We are indeed surprised that Appellee has cited said decision because when reference was made to the decision in the lower Court, counsel for Appellee stated "we are not relying on this case" (TR. 125-124).

Inasmuch as the *Textile* case involved expenditures incurred in connection with legislation pending in "legislative halls", the lower courts in the above cases [except for the *Cullen* case which was decided in 1940], without considering further whether or not the *Textile* decision was limited to only certain types of lobbying in legislative halls, followed said decision.

In any event the instant expenditures were not in any way incurred in connection with legislation pending in "legislative halls" or for "lobbying" in "legislative halls".

Furthermore, Appellee in its brief admits that the application of the Regulation to the instant expenditures cannot be justified on grounds of public policy (Appellee's Br. 6, 18-23).

- (c) Decisions where the Regulation may be regarded as having been validly applied within the authorized rule-making authority of the Commissioner in interpreting "ordinary and necessary" and where the expenditures only indirectly or remotely affected taxpayer's business.

In the *American Hardware* and *Roberts Dairy* decisions, *supra*, the expenditures were made to associations which in turn used the sums in the furtherance of the enactment of legislation placing heavier tax burdens upon competitive cooperatives. Inasmuch as the expenditures only remotely and indirectly affected taxpayers, the expenditures may be said to have been properly barred by the Regulation aside from considerations of public policy. In *Old Mission P. Cement Co. v. Commissioner*, 69 F. 2d 676 (C. A. 9th), the expenditures only remotely affected taxpayer's business and the Court properly found the expenditures not ordinary and necessary without referring to the Regulation. In *Sunset Scavenger Co. v. Commissioner*, 84 F. 2d 453 (C. A. 9th) the expenditures made in 1927 pertained to an ordinance providing for an additional method of issuing scavengers' licenses and the expenditures in 1929 pertained to a measure which was merely a declaration of policy regarding the municipal collection of garbage—any future definitive action was reserved to the Board of Supervisors. In both instances therefore the effect of the measures on taxpayer's business was conjectural and remote. The Court rested its final decision on the *Old Mission* case where no regulation was involved. In *Wm. T. Stover Co. v. Commissioner*, 27 T.C. No. 48, taxpayer, engaged in the sale of medical supplies, incurred expenditures in sending a reporter to Great Britain for

the purpose of publishing a report on socialized medicine favorable to the physician customers of taxpayer, who in turn were interested in legislation relating to socialized medicine. Thus the expenditures only very remotely affected taxpayer's business.

The expenditures in the foregoing cases only indirectly and remotely affected taxpayers' business and therefore may be regarded as falling within the field of a valid application of the Regulation and within the authorized rule-making authority of the Commissioner. In contrast, the instant expenditures were made to preserve the very life of taxpayers' business: had the Initiative been enacted taxpayers would have been deprived of all their existing customers. Taxpayers were wholesalers and their customers were retailers. The Initiative expressly provided that after its enactment all retailers were prohibited from selling beer.<sup>1</sup>

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<sup>1</sup>In *Morgan v. Tate & Lyle, Ltd.*, (1953) Ch. 601 (C.A.), (1953) 2 All E. R. 162, (1953) 1 W.L.R. 145, *aff'd* (1954) 2 All E.R. 413, (1955) A.C. 21 (House of Lords), involving a factual situation almost identical to the instant case and holding that expenditures by a sugar refining company in a publicity campaign against proposed nationalization of the British sugar refining industry were deductible from gross income as "disbursements or expenses . . . laid out or expended for the purposes of the trade . . .", the Court of Appeal said: "If my goods do not appeal to the public and my competitor's do, he and not I will earn the profits which are to be made by selling the class of article which I have to offer. I therefore institute an advertising campaign with the object of belauding my goods and dispraising his: my design is that customers shall resort to my shop and not to his when they require the article in question. So here, the consumer is to be persuaded that he (or she) will get more or better or cheaper sugar by allowing the trade to be controlled by the respondents and their rivals than by entrusting it to the hands of the pundits in Whitehall. It is conceded that the expense of a campaign of the former sort would be allowable; and rightly, for the money is laid out for the purposes of the trade. Equally so, in my judgment, is money spent on the latter object." (1953) 1 W.L.R. at pp. 155-156 (italics ours).

In contrast to the lower Court decisions so cited by Appellee, the Supreme Court in *Commissioner v. Heininger*, supra, has emphatically and clearly stated that expenditures incurred in the defense of and in the preservation of the continuance of an existing business are "ordinary and necessary" within the language of Section 23(a) beyond question. The *Heininger* holding was expressly reaffirmed in the subsequent *Lilly* case.

In *Bingham's Trust v. Commissioner*, 325 U.S. 365, the Supreme Court held that to the extent a regulation bars as a deduction expenditures which are ordinary and necessary, such application of the regulation is invalid.

Appellee has not replied to the three foregoing cases so cited by taxpayers—beyond the statement of a general conclusion that said cases "are not applicable". (Appellee's Br. 22.)

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(2) REPLY TO CONTENTION: "AT THE OUTSET, TAXPAYERS QUESTION (Br. 11-22) WHETHER THIS PROHIBITION CONTAINED IN SECTION 29.23(o)-1 OF THE REGULATIONS IS APPLICABLE TO SECTION 23(a)(1)(A) OF THE STATUTE." (Appellee's Br. 9.)

The foregoing statement is not correct. Taxpayers explicitly stated at page 21 of their brief: "In the topics considered in this brief relating to the rule-making authority of the Commissioner [but not with respect to the topic of statutory re-enactment] . . . the Regulation relating to individuals may be referred to Sec. 23(a)."

On the other hand in considering the question of statutory re-enactment it is obvious that the history, indexing, captioning and the Commissioner's interpretation of the Regulation are important factors because: the basis of statutory re-enactment in any event can rest only on the imputation that Congress in re-enacting Section 23(a) did so with the Regulation in mind.

In seeking to refute a position not taken by taxpayers, Appellee has set forth at great length the history of the Regulation relating to corporations with only glancing reference to the history, indexing and captioning of the Regulation pertaining to individuals. It is important to observe that the provision of the Regulation here in question was not inserted in the Regulation pertaining to individuals until 1939—twenty-one years after the insertion of said provision in the Regulation pertaining to corporations. It is not for taxpayers to suggest why the difference in the Regulations during all those years. It should be observed, however, that in connection with other subjects Congress saw fit to treat individuals differently from corporations: thus an individual even though engaged in business was permitted to deduct charitable contributions, whereas a corporation was not so permitted until 1935.

It should also be observed that aside from a compilation of the already existing internal revenue laws in the Internal Revenue Code of 1939 and the addition of sub-paragraph (a)(1)(C) in 1941 [1941 Excess Profits Tax Amendments, Sec. 10(b)], Section

23(a), at the time of the taxable events in the instant case, had only at the very most been re-enacted once from the time of the first insertion of the provision relating to "lobbying" in the Regulation pertaining to individuals: in 1942 paragraph numbered (1) was changed to (1)(A) and the heading "Trade or Business Expenses" was inserted. During all of this time the Regulation was indexed and captioned under Section 23(o) an entirely different section of the Code in concept and purpose from Section 23(a). Section 23(o) was captioned and dealt with "Charitable and other contributions". The Regulation in its body repeatedly referred to Section 23(o). Buried in the midst of the voluminous provisions of the Regulation dealing solely with charitable contributions was the provision here in question purporting to deal with business expenses (for text of Regulation see Appellants' Brief, Appendix, page i). In the light of these circumstances it is entirely fictional and unreasonable to even remotely impute to Congress a knowledge of the provision.

It is significant that the Treasury, since the *Cammarano* case, in proposed Income Tax Regulations under the Revenue Code of 1954 is now indexing the Regulation under Section 162 (successor to Section 23(a)), rather than under Section 170 (the successor to Section 23(o)). [Appellee's Br. 13, f.n. 1.]

- (3) REPLY TO CONTENTION: "THE GENERAL PRINCIPLE THAT REPEATED CONGRESSIONAL REENACTMENT OF THE STATUTORY PROVISION TO WHICH A REGULATION PERTAINS, HERE SECTION 23(a)(1) (A) OF THE 1939 CODE, GIVES TO THE REGULATIONS THE FORCE OF LAW . . ." Appellee's Br. 14).

In the three Supreme Court decisions cited by Appellee, application of the regulation did not directly contravene the provisions of the statute. The principle of statutory re-enactment has never been invoked where the application of a regulation with respect to particular facts directly contravenes a statute because where "the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation", *Koshland v. Helvering*, 298 U.S. 441, 447 (1936) (successive re-enactments of a statute after the issuance of a regulation). "Long-continued practice and approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, but cannot alter provisions that are clear and explicit when related to the facts disclosed", *Louisville & N.R. Co. v. U.S.*, 282 U.S. 740, 759 (1931) (italics ours) (repeated re-enactments of a statute after issuance of a regulation). "The most familiar limitation upon the doctrine of re-enactment is the qualification that if the regulation definitely goes beyond the limits of the statute, no amount of legislative re-enactment will validate the ruling. To hold otherwise would mean that taxpayers could never rely upon the clearest terminology of a statute". *Studies in Federal Taxation, Third Series*, Randolph E. Paul, (p. 435) (italics ours).

Here the expenditures as stated by the Supreme Court in *Commissioner v. Heininger*, supra, are ordinary and necessary beyond question. To apply the Regulation to such expenditures would therefore directly contravene Section 23(a) and would be tantamount to an abrogation of the statute as applied to the instant expenditures. Clearly the doctrine of statutory re-enactment cannot be invoked to produce such a paradox: that the taxpayer should be remitted to a regulation to ascertain whether a particular application of a statute has been revoked—and here under circumstances where the provision of the Regulation was not even indexed or captioned under Section 23(a) and where the provision was buried in the midst of the voluminous regulation pertaining to charitable deductions.

Appellee cites *Sunset Scavenger Co. v. Commissioner*, supra. But that case also made express reference to the limitation that the doctrine of statutory re-enactment is not applicable where "the language of the act is unambiguous and the regulation clearly inconsistent with it" (page 457).

Appellee cites the *Textile* case. Statutory re-enactment was not discussed or mentioned in that decision. Furthermore the Court characterized the Regulation as a "ban" against "lobbying" in "legislative halls". Such characterization of the Regulation immediately raises the question: what scope or construction of the Regulation could possibly be imputed to Congress under any theory of statutory re-enactment?

It certainly would be paradoxical to impute to Congress a construction of the purported scope of the Regulation contrary to that of the Commissioner. Yet here the Commissioner, by his acquiescence in *Luther Ely Smith v. Commissioner*, 3 T. C. 696—promulgated after the decision in the *Textile* case and never withdrawn—has publicly and unequivocally declared that expenditures incurred in connection with measures voted upon by the People are deductible where they are found to be ordinary and necessary. Taxpayers, of course, are unable to state what reasons prompted the Commissioner to publicly announce said acquiescence other than the fact that expenditures incurred in connection with measures submitted to the People involve considerations of policy entirely different than those involved in “lobbying”. It is pertinent to observe that the Commissioner’s acquiescence conforms with: the initial construction which the Commissioner gave the Regulation pertaining to corporations which he initially captioned “Lobbying Expenses”<sup>2</sup>, and also conforms with the construction which the Supreme Court placed on the Regulation pertaining to corporations in the *Textile* case. It is significant to note that the acquiescence

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<sup>2</sup>See Appellee’s Br. 11, f.n. 1: “As pointed out, supra, both T.D. 2137, and Article 143 of Treasury Regulations 33 (1918 ed.), were an interpretation of the phrase ‘ordinary and necessary’, and both incorporated the prohibition under provisions labelled ‘Lobbying Expenses’.” (italics ours) In *U.S. v. Rumely*, 345 U.S. 41 (1953), the Supreme Court held that the word “lobbying” does not embrace “attempts to saturate the thinking of the community” (p. 47).

of the Commissioner took place after the decision in the *Textile* case.

Thus the theory of statutory re-enactment cannot be invoked: first, because the instant application of the Regulation would directly contravene Section 23(a); secondly, because of the captioning, indexing and context of the Regulation; and, finally and conclusively, because the Commissioner himself has not construed the Regulation as applicable to the instant expenditures as evidenced by his acquiescence in the *Luther Ely Smith* decision, *supra*.

It is pertinent to note that the trend of recent Supreme Court cases accords only limited or no recognition to the theory of statutory re-enactment. Thus the Supreme Court has spoken of the theory as "at best only an auxiliary tool for use in interpreting ambiguous statutory provisions", *Jones v. Liberty Glass Company*, 332 U.S. 524, 534 (1947) and as "an unreliable indicium at best", *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

(4) REPLY TO CONTENTION: "THE TWO SUPREME COURT DECISIONS MOST RELEVANT TO THE PRESENT PROCEEDINGS ARE TEXTILE MILLS CORP. v. COMMISSIONER, SUPRA, AND McDONALD v. COMMISSIONER, 323 U.S. 57." (Appellee's Br. 15.)

The *Textile* decision will be discussed under the next topic.

*McDonald v. Commissioner* is clearly distinguishable. Section 23(a), aside from the requirement that

the expenditures must be "ordinary and necessary", provides that the expenditures must be incurred "in carrying on any trade or business". Implicit in the latter requirement is a present relationship of the expenditures to an existing business—not a future business. Thus where a Judge seeks to be newly elected to office, the expenditures clearly are referable to a future business and not an existing business; also where a Judge seeks to be re-elected his expenditures are likewise referable to a future business because his present office is only for an expirable term and the expenditures therefore have no relation to the present term of his business.

In contrast to the expenditures in the *McDonald* case and in similar cases cited, the instant expenditures pertained to a presently existing business, the very existence of which would have been destroyed had the Initiative passed because: the business would have been deprived of all of its existing customers. The expenditures so incurred in defending and preserving an existing business are the same as those which the Supreme Court found "ordinary and necessary" beyond question in *Commissioner v. Heininger*, supra. The Court there said: "There can be no doubt that the legal expenses of respondent were directly connected with 'carrying on' his business." (p. 470)

The two most relevant decisions of the Supreme Court are not the two decisions cited by Appellee but, on the contrary, are: *Commissioner v. Heininger*, supra, expressly affirmed in *Lilly v. Commissioner*, supra, holding that expenditures of the character here

involved are "ordinary and necessary" beyond question, and *Bingham's Trust v. Commissioner*, supra, holding that a regulation to the extent it bars as a deduction expenditures which are "ordinary and necessary", is invalid.

Appellee has not replied to those decisions.

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(5) REPLY TO CONTENTION: "CONTRARY TO THE CONTENTION RAISED BY TAXPAYERS (Br. 42-58, 66-67, 74-75), THE REGULATION IS NOT LIMITED TO THOSE EXPENDITURES WHICH ARE IMPROPER, CORRUPT, OR AGAINST 'PUBLIC POLICY', NOR ONLY TO THOSE WHERE DIRECT PRESSURE IS BROUGHT UPON A LEGISLATURE." (Appellee's Br. 18.)

Appellee has misunderstood taxpayers' contentions. In the very first contention set forth in taxpayers' brief, taxpayers maintained—aside from any question of public policy—that application of the Regulation was clearly in excess of the rule-making authority of the Commissioner "within the limits of a reasonable interpretation" of the will of Congress expressed in the Code (Appellants' Br. 23).

It is not incumbent upon taxpayers in this case, nor is it a material issue, to delineate the detailed outer boundaries of the area within which the Regulation may be validly applied by the Commissioner in the exercise of such rule-making authority. It is sufficient alone to show that the application of the Regulation by the Commissioner is clearly out of bounds. Thus the issue here is not the broad general issue which the Appellee seeks to make: whether the Regulation in the abstract is valid or whether the

Regulation as applied to other and different facts is valid.

That the Regulation—aside from public policy—may be validly applied to some expenditures referred to in the Regulation and within the rule-making power of the Commissioner in interpreting “ordinary and necessary” we need not dispute. Thus it may be reasonably contended that the Regulation may be validly applied to expenditures referred to in the Regulation which only remotely or indirectly affect taxpayer’s business, such as those set forth in the decisions referred to in the third classification of cases set forth under topic (1) of this brief.

Taxpayers, lastly, in their brief maintained that the Regulation cannot be validly applied to the instant expenditures on the ground of public policy (Appellants’ Br. 42-58). This contention is entirely separate and apart from the first contention that the Regulation cannot be validly applied in the exercise of the rule-making authority of the Commissioner in reasonably interpreting what is “ordinary and necessary”.

The two contentions involve entirely different considerations. Thus in considering whether the Regulation can be validly applied on the ground of public policy, it is not necessary to consider whether the particular expenditures factually are “ordinary and necessary” beyond question. Once the expenditures are determined to be against public policy they are outlawed and non-deductible without any further consideration of the question whether they are “ordinary and necessary” within the clear and accepted meaning of

those words. The expenditures so outlawed may simply be regarded as non-deductible irrespective of their character or alternatively it may be held that expenditures which violate public policy clearly cannot be regarded as being "ordinary and necessary". Thus in the *Textile* case the expenditures were outlawed on the ground of public policy and no further consideration was required.

Appellee clearly admits, however, that the Regulation cannot be validly applied to the instant expenditures on the ground of public policy. Appellee states: ". . . it is immaterial whether . . . the promotion or defeat of legislation . . . is against 'public policy' for the regulation applies to all attempts to influence the promotion or defeat of legislation". (Appellee's Br. 6; see also pp. 18-23.)

With the elimination of the "public policy" issue from this case, the remaining issue is confined to the question whether: the Regulation as here applied is in excess of the administrative rule-making authority of the Commissioner in reasonably interpreting the will of Congress expressed in the factual words "ordinary and necessary" contained in Section 23(a).

Even though the basis of the decision in the *Textile* case was clearly stated to be public policy, Appellee, nonetheless, contends that said decision is controlling here. Appellee contends that the items disallowed in the *Textile* case were not for "lobbying" and that the existence of the contingent fee contracts was not a factor in the decision (Appellee's Br. 19). But it is clear that the services rendered and expenditures in-

curred in connection therewith had only one single objective: to reach Congress with respect to pending legislation. Thus the Court clearly said "Petitioner's employment was made with a view towards procuring legislation . . ." (p. 336). The court expressly characterized the expenditures as expenditures for "lobbying" (p. 337) and the contracts as "Contracts to spread such insidious influences through legislative halls have long been condemned" (p. 338). The concluding statement by the Court clearly shows that the decision was based on public policy: "There is no reason why, in the absence of clear Congressional action to the contrary, the rule-making authority cannot employ that *general policy* in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction" (p. 339) (italics ours). "The *general policy* being clear it is not for us to say that the line was too strictly drawn". (p. 339) (italics ours.)

Appellee contends taxpayers construe too "narrowly" the decision in the *Textile* case (Appellee's Br. 21). But it is not taxpayers' construction of the decision—it is the construction of the Supreme Court itself in two subsequent cases wherein the Court clearly said, with respect to the *Textile* case: "Similarly, one who has incurred expenses for *certain types of lobbying* and political pressure activities with a view to influencing federal legislation has been denied a deduction", *Commissioner v. Heininger*, supra, (p. 473) (italics ours); "In *Textile Mills Securities Corp. v. Commissioner*, 314 US 326, 86 L ed 249, 62 S Ct

272, this Court accepted an interpretation of that section by a Treasury Regulation which disallowed the deduction of *certain expenditures for lobbying purposes*. In doing so, the Court referred to the fact that some types of lobbying expenditures had long been condemned by it . . .”, *Lilly v. Commissioner*, supra (p. 95) (italics ours).

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(6) REPLY TO CONCLUDING CONTENTION AND BASIC ERROR OF APPELLEE IN ASSERTING THAT SMITH v. COMMISSIONER AND COMMISSIONER'S ACQUIESCENCE THEREIN HAS “LOST ITS BASIS WITH THE TEXTILE MILLS DECISION”. (Appellee's Br. 22.)

In the closing paragraph of its brief Appellee states: “Smith v. Commissioner, 3 T.C. 696 (Acquiescence 1944 Cum. Bull. 26), decided prior to *Textile Mills*, held deductible contributions by a lawyer . . .” (Appellee's Br. 22) (italics ours).

*Appellee is in error.* The decision in the *Smith* case and the Commissioner's acquiescence therein (both in 1944) took place three years *after* the decision in the *Textile* case (1941).

Appellee, resting on this basic error, asserts that the decision in *Smith v. Commissioner* and the Commissioner's acquiescence therein “lost its basis with the *Textile Mills* decision . . .” (Appellee's Br. 22).

On the contrary, the decision in the *Smith* case and Commissioner's acquiescence therein, being subsequent to the *Textile* case, are in conformity with the *Textile*

case and are an express recognition of the limitations of that decision.<sup>3</sup>

It is also significant that the decision in the *Smith* case and Commissioner's acquiescence therein were subsequent to the decision in the *Scavenger* case (1936).

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#### CONCLUSION.

The Commissioner by his holding in this case has placed Appellant taxpayers and other taxpayers similarly situated in an impossible position.

Prior to incurring the expenditures, the Commissioner by his acquiescence in the *Smith* case publicly declared that expenditures incurred in connection with measures voted upon by the People, where factually they are "ordinary and necessary"—are deductible.

But once the expenditures were incurred, the Commissioner seeks to repudiate his prior public declaration and now contends that the expenditures, even though in fact "ordinary and necessary", all the while were categorically barred by a regulation and therefore—are not deductible.

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<sup>3</sup>It is to be noted that in 1950 the Tax Court reaffirmed the *Smith* case in *Roberts Dairy Co. v. Commissioner*, 9 T.C.M. 000 (involving expenditures incurred in connection with legislation by Congress), wherein the Court stated: "Petitioner has cited several cases as authority for allowing this deduction as a business expense which we think inapplicable. In *Luther Ely Smith*, 3 T. C. 696 [Dec. 13,891], the Court held that no legislation was involved inasmuch as an amendment to the Constitution of the State of Missouri was voted by the people and became self-operative without approval of the legislature." [p. 1003]

However, aside from the inequity of the Commissioner's ruling, taxpayers here are supported by the law because the Supreme Court has clearly held: (1) Expenditures of the character here incurred in preserving the continued existence of a business are "ordinary and necessary" beyond question and hence deductible within the will of Congress expressed in Section 23(a), *Commissioner v. Heininger*, *supra*; *Lilly v. Commissioner*, *supra*; (2) The Regulation to the extent it bars such expenditures as a deduction is in contravention of Section 23(a) and therefore is invalid and in excess of the rule-making authority of the Commissioner in administering Section 23(a); *Bingham's Trust v. Commissioner*, *supra*.

Wherefore Appellants respectfully contend that the judgment of the District Court was in error and that accordingly, the judgment be reversed.

Dated, San Francisco, California,  
May, 1957.

Respectfully submitted,

ATHEARN, CHANDLER & HOFFMAN,

WALTER HOFFMAN,

CLARK W. MASER,

JONES & GREY,

A. R. KEHOE,

HARGRAVE A. GARRISON,

Attorneys for Appellants.

No. 15,350

IN THE  
**United States Court of Appeals  
For the Ninth Circuit**

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WILLIAM B. CAMMARANO and LOUISE  
CAMMARANO, his wife,  
vs.  
UNITED STATES OF AMERICA,

*Appellants,*  
*Appellee.*

---

**PETITION FOR REHEARING AND  
FOR REHEARING EN BANC.**

---

ATHEARN, CHANDLER & HOFFMAN,  
WALTER HOFFMAN,  
CLARK W. MASER,  
Seventh Floor, Balboa Building,  
San Francisco 5, California,  
JONES & GREY,  
A. R. KEHOE,  
HARGRAVE A. GARRISON,  
610 Colman Building, Seattle, Washington,  
*Attorneys for Appellants.*

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PAUL P. O'BRIEN,



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No. 15,350

IN THE

**United States Court of Appeals  
For the Ninth Circuit**

---

WILLIAM B. CAMMARANO and LOUISE  
CAMMARANO, his wife,  
VS.  
UNITED STATES OF AMERICA,

*Appellants,*  
*Appellee.*

---

**PETITION FOR REHEARING AND  
FOR REHEARING EN BANC.**

---

*To the Honorable Judges of the United States Court  
of Appeals for the Ninth Circuit:*

Petitioners, Appellants herein, respectfully submit that the opinion rendered by this Court in the above matter is erroneous in the particulars hereinafter stated and respectfully pray that a rehearing be granted and further that said rehearing be en banc, for reasons hereinafter set forth.

## I.

THE OPINION REPEATEDLY AND IN FIVE INSTANCES REFERS TO THE SUBJECT AND COMPASS OF THE REGULATION AS A "LOBBYING" REGULATION. THE OPINION, HOWEVER, ERRONEOUSLY CONCLUDES THAT THE INSTANT EXPENDITURES WERE FOR LOBBYING AND HENCE FALL WITHIN THE VALID APPLICATION OF THE REGULATION.

The italics in the quotations from the opinion hereafter quoted are ours. The full text of the opinion is set forth in the Appendix.

At page 2, last paragraph, line 1, the opinion states: "the field encompassing the force and effect of the *lobbying regulation* set out above . . ."

At page 3, first paragraph, line 9, the opinion states: ". . . the ban against deductions of amounts spent for *lobbying* as ordinary and necessary expenses is valid . . ."

At page 3, f.n. 4, line 5, the opinion states: "The Court there related the *lobbying regulation* to ordinary and necessary business expenses . . ."

At page 4, first paragraph, line 8, the opinion states: ". . . that the *lobbying regulation* was inapplicable to ordinary business expenses . . ."

At page 5, f.n. 5, line 1, the opinion states: "The *lobbying regulation* assumed its present form . . ."

The foregoing recurrent characterization of the scope and compass of the Regulation as a "lobbying regulation" is correct. It conforms with the interpretation and valid scope of the Regulation referred to in the *Textile* case where the Supreme Court characterized the Regulation as a "ban against deductions

of amounts spent for ‘lobbying’ ” (314 U.S. 326, 337). It conforms with a similar interpretation which the Supreme Court subsequently placed upon the *Textile* case and the Regulation in the *Heininger* and *Lilly* cases wherein the Court referred to the interpretation of the Regulation in the *Textile* case as embracing: “expenses for certain types of lobbying” (320 U. S. 467, 473); and “certain expenditures for lobbying purposes” (343 U. S. 90, 95). It conforms with the interpretation which the Commissioner himself initially placed on the corporate Regulation in giving it the heading “Lobbying Expenses.”

On the basis of the foregoing interpretation and compass of the valid application of the Regulation, the opinion then arrives at the following ultimate conclusion: “We think it may reasonably be gathered from a reading of *Textile Mills* that the Commissioner, in segregating sums paid for *lobbying* as non-deductible as ordinary and necessary business expenses, acted within the proper exercise of his rule-making power.” (p. 3, first paragraph, line 16) (italics ours).

That conclusion in the light of the clearly stated and constantly repeated premise of the opinion—that the Regulation is a “lobbying regulation”—is incorrect because: the instant expenditures were not for “lobbying.”

“Lobbying” only relates to activities with respect to matters pending in “legislative halls.” The term does not embrace and apply to expenditures incurred for publicity in connection with measures voted upon by the People. In *United States v. Rumely*, 345 U. S.

41, 47 (1953) the Supreme Court clearly defined "lobbying" as only embracing "representations made directly to the Congress, its members, or its committees'" and as not including "attempts 'to saturate the thinking of the community'". [See also: *United States v. Harriss*, 347 U. S. 612, 620 (1954)].

The Supreme Court's interpretation of the valid scope and application of the Regulation as a ban against "lobbying" in the *Textile*, *Heininger* and *Lilly* cases thus can have only one meaning according to the Supreme Court's own definition of the term: activities in connection with matters pending in "legislative halls".

It should further be noted that the opinion on page 4, fifth paragraph, line 1, by direct implication erroneously refers to the instant expenses as "lobbying" expenditures in the following language: "Those cases are distinguishable in that the regulation here involved was not applicable; there was no *lobbying* involved." (italics ours).

Thus, the opinion, in setting forth the foregoing crucial conclusion, is inconsistent on its face with the repeated premise stated in the opinion: that the compass and scope of the Regulation is "lobbying."

## II.

THE OPINION IN HOLDING THAT THE REGULATION MAY BE VALIDLY APPLIED TO BAR THE INSTANT EXPENDITURES ERRONEOUSLY CONSTRUES THE LANGUAGE OF THE TEXTILE CASE WHEREIN THE COURT SAID THAT THE WORDS "ORDINARY AND NECESSARY" ARE NOT SO CLEAR AND UNAMBIGUOUS IN THEIR MEANING AS TO LEAVE NO ROOM FOR AN INTERPRETIVE REGULATION.

The opinion in referring to the *Textile* case states: "However, other language in *Textile Mills* characterizes the words 'ordinary and necessary' as used in the statute, as not being 'so clear and unambiguous in their meaning and application as to leave no room for an interpretive regulation'" (p. 3, first paragraph, line 12).

In the next sentence of the opinion (being the same sentence quoted under the previous topic) and on the basis of the foregoing statement, the opinion concludes that the Supreme Court was referring to an interpretation and application of the Regulation embracing within its compass any expenditures referred to in the Regulation *irrespective of whether such expenditures are illegal or violate public policy*.

The Supreme Court, in succeeding sentences found in the same paragraph from which the foregoing quotation was taken, clearly indicated that the Court was approving an interpretation and application of the Regulation embracing only: activities of a certain character in "legislative halls" *which are illegal or contrary to clearly defined public policy*.

Thus, the Supreme Court in the succeeding sentences in the same paragraph, in referring to two Su-

preme Court cases involving illegality, said: "The point is that the general policy indicated by those cases need not be disregarded by the rule-making authority in its segregation of nondeductible expenses. There is no reason why in absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction. *The exclusion of the latter from 'ordinary and necessary expenses' certainly does no violence to the statutory language.*" (314 U.S. at p. 339) (italics ours).

The Supreme Court therefore clearly held that the words "ordinary and necessary" are not "so clear and unambiguous in their meaning and application as to leave no room for an interpretive regulation" by the Commissioner validly barring expenditures as a deduction where such expenditures, incurred in connection with lobbying, are *illegal or contrary to public policy*, even though Congress was silent on the subject and even though such expenditures otherwise may factually be ordinary and necessary. Thus, if the expenditures of the type referred to in the Regulation are illegal or contrary to well defined public policy they may be regarded as not being "ordinary or necessary" within the meaning of Section 23(a)(1)(A) because it cannot be presumed that business men would ordinarily incur illegal expenditures or expenditures contrary to well defined public policy even though such expenditures otherwise in fact may be ordinary and necessary.

It is clear, therefore, that the Supreme Court in the *Textile* case did not hold that the words "ordinary and necessary" are unclear or ambiguous as applied to any other expenditures within the literal language of the Regulation where such expenditures *are not illegal or contrary to public policy*.

The foregoing construction of the language used by the Supreme Court in the *Textile* case conforms with the subsequent interpretation of the *Textile* case by the Supreme Court in the *Heininger* and *Lilly* cases wherein the Court plainly stated that the holding in the *Textile* case was based upon public policy.

Only by taking the foregoing construction of the language used by the Court in the *Textile* case, can the decision in that case be squared with the subsequent emphatic statement of the Supreme Court in the *Heininger* case wherein the Court said that to hold that expenditures are not ordinary and necessary, where such expenditures are incurred in defending an existing business and existing "selling methods" and are not illegal or against public policy, "would be to ignore the ways of conduct and the forms of speech prevailing in the business world" (320 U. S. at p. 472).

Surely the same must be said of expenditures incurred by individuals in the exercise of the right of free speech and clearly in furtherance of public policy—in defending a business from the enactment of a measure which taxpayers reasonably believed would have deprived them of all their existing cus-

tomers and would have destroyed their existing "method" of selling and doing business.

Therefore, the opinion of this Court, in holding that the language of the Supreme Court previously quoted validly sanctions an interpretation and application of the Regulation so as to embrace within its compass the instant expenditures, is erroneous.

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### III.

THE OPINION IS ERRONEOUS IN HOLDING THAT THE APPLICATION OF THE REGULATION TO THE INSTANT EXPENDITURES HAS RECEIVED CONGRESSIONAL SANCTION BECAUSE OF A "KNOWN ADMINISTRATIVE INTERPRETATION." ON THE CONTRARY, THE KNOWN ADMINISTRATIVE INTERPRETATION ALLOWED SUCH EXPENDITURES AS A DEDUCTION. HENCE IF ANY THEORY OF STATUTORY RE-ENACTMENT IS TO BE INVOKED IT IS DIRECTLY OPPOSITE TO THAT REFERRED TO IN THE OPINION.

The opinion states (p. 4, last paragraph): "This court in *Sunset Scavenger v. Commissioner*, 9 Cir., 1936, 84 F.2d 453, held that the doctrine of statutory re-enactment in the face of a known administrative interpretation applied in that case. We think that doctrine can be said to apply with equal force in the instant case."

The *Sunset* case was decided in 1936. The Regulation here involved and pertaining to individuals was first issued in 1939.

In the *Textile* case, decided in 1941, the highest court in the land referred to the parallel corporate Regulation as a "ban against lobbying."

In 1944 the Commissioner publicly acquiesced in *Luther Ely Smith v. Commissioner*, 3 T.C. 696 (1944). In that case the Tax Court held deductible expenditures incurred for publicity in connection with a measure voted upon by the People affecting taxpayer's occupation as a lawyer.

It is not necessary to consider the merits of the *Luther Ely Smith* case. The point is that the Commissioner publicly acquiesced in that decision, which acquiescence has never been withdrawn. (Acquiescence 1944 Cum. Bull. 26.)

The opinion of this Court nowhere refers to the Commissioner's acquiescence in the *Luther Ely Smith* case. On the other hand, the opinion merely mentions "a known administrative interpretation" referred to in the *Sunset* case which was decided in 1936—prior to the issuance of the Regulation here in question—prior to the decision of the Supreme Court in the *Textile* case—and prior to the Commissioner's acquiescence in the *Luther Ely Smith* case.

Furthermore, the Commissioner on the basis of his acquiescence in the *Luther Ely Smith* case, thereafter and until the *Cammarano* case, allowed the beer industry to deduct expenditures for publicity incurred in connection with measures submitted to a vote of the People. The practice was evidenced by private rulings of the Commissioner in letter form.

This Court erroneously refused to take judicial notice of such written communications. The Supreme Court of the United States, however, has held di-

rectly to the contrary. In *Jones v. United States*, 137 U. S. 202 (1890), the Supreme Court held that a Federal District Court had the power to take judicial notice of unpublished letters between the Secretary of State and various private persons. [And See: *American Legion Post No. 90 v. First Nat. Bk. & T. Co.*, 113 F.2d 868, 872 (2d Cir. 1940)].

In the face of the Commissioner's published acquiescence in the *Luther Ely Smith* case, which took place subsequent to the decision in the *Textile* case and therefore indicates the Commissioner's own interpretation of that case and the Regulation, and in view of the Commissioner's own practice in allowing the beer industry to deduct such expenditures until the advent of the *Cammarano* case, how then can the opinion under any theory of statutory re-enactment impute to Congress knowledge of an administrative interpretation which is directly contrary to the fact?

## IV.

THE OPINION IS IN ERROR: IN HOLDING THAT THE LOWER COURT IN FINDING NO. 9 FOUND THAT THE APPELLANTS FAILED TO SUSTAIN THE BURDEN OF PROOF THAT THE INITIATIVE WOULD HAVE IMPAIRED THEIR BUSINESS AND FURTHER IN HOLDING THAT THE BURDEN OF PROOF OF DEDUCTIBILITY UNDER LAW IS CONFINED TO PROOF AND A FINDING THAT THE BUSINESS WOULD HAVE BEEN IMPAIRED. SUCH A FINDING HAS NO LEGAL SIGNIFICANCE AND IS ERRONEOUS BECAUSE THE ONLY OTHER ISSUE WHICH THE COURT COULD FIND, ASIDE FROM THE VALIDITY OF THE REGULATION, IS THE ENTIRELY DIFFERENT ISSUE: WHETHER THE EXPENDITURES WERE OR WERE NOT "ORDINARY AND NECESSARY" WITHIN THE LANGUAGE OF THE CODE. FINDING NO. 9 CLEARLY CANNOT BE CONSTRUED AS A FINDING THAT THE APPELLANTS FAILED TO MEET THE BURDEN OF SHOWING THAT SUCH EXPENDITURES WERE "ORDINARY AND NECESSARY".

The Finding referred to reads:

"9. There was testimony to the effect that the Initiative, if passed, would have affected the wholesale business of Cammarano Brothers. However, the way in which the measure, aimed as it was at retail sales of wine and beer, would have affected the wholesale distribution of beer was not made clear. In any event, the measure was defeated."

The first sentence is clearly a finding by the Court that there was testimony that the Initiative "would have *affected* the wholesale business of Cammarano Brothers." The uncontroverted testimony referred to was that at least 90% of the wholesalers would have been put out of business. If the Court had stopped with that sentence in its finding, no question could have been raised in the opinion of this Court regard-

ing a failure to show that the Initiative affected the wholesale business of Cammarano Brothers.

The lower Court, however, went further in its finding, and, while admitting the business would have been affected, then stated that the manner in which it would have been affected was not made clear. The lower Court, next and in the concluding sentence of the finding, plainly indicated that in any event the effect upon the business was not a material issue to the case, stating: "In any event, the measure was defeated." The foregoing remark by the lower Court cannot be given any other significance because the question of whether the expenditures were deductible certainly would not turn on the defeat or enactment of the measure.

The record in the Court below from beginning to end clearly shows that the opinion of this Court misconstrues Fndng No. 9 and that the lower Court held that the Regulation barred the expenditures without need for further consideration of any alternate question in the case: whether the expenditures otherwise in fact were ordinary and necessary.

The Commissioner in his report denied the deduction on the sole ground that the expenditures were barred by the Regulation without making any further determination whether the expenditures otherwise were factually ordinary and necessary. (See first paragraph of this Court's opinion, p. 2.)

The Government, in the lower Court, at the outset admitted plaintiff's business would have been affected by enactment of the Initiative. Counsel for the Gov-

ernment in the Government's trial memorandum said: "Concededly, Initiative 13 would have affected a portion of plaintiffs' business, and perhaps would have put them out of business entirely." (TR 18.) That statement was a solemn judicial admission binding for all purposes in the case.

Thus, 5 Wigmore, *Evidence* (2d ed. 1923) declares: "An express waiver, made in court or preparatory to trial, by the party or his attorney, conceding for the purposes of the trial the truth of some alleged fact, has the effect of a confessory pleading, in that the fact is thereafter to be taken for granted; so that the one party need offer no evidence to prove it, and the other is not allowed to disprove it. This is what is commonly termed a . . . *judicial admission*, . . . It is, in truth, a substitute for evidence, in that it does away with the need for evidence" (§ 2588). "The vital feature of a judicial admission is universally conceded to be its *conclusiveness* upon the party making it, *i.e.*, the prohibition of any further dispute of the fact by him, and of any use of evidence to disprove or contradict it" (§2590). "A fact that is judicially admitted *needs* no evidence from the party benefiting by the admission" (§2591).

To the same effect is the statement by the Supreme Court in *Oscanyan v. Winchester R. Arms Co.*, 103 U.S. 261, 263 (1881) that: ". . . any fact, bearing upon the issues involved, admitted by counsel, may be the ground of the court's procedure equally as if established by the clearest proof." [And See: *O. F. Nelson & Co. v. United States*, 149 F.2d 692, 694-695 (9th Cir. 1945)].

The Government subsequently in the trial sought to minimize the admission so made (TR 73-74). The effect of the admission, of course, could not be erased any more than any factual admission by a party to litigation can be subsequently withdrawn by his subsequent desire so to do [see: *State Farm Mut. Auto. Ins. Co. v. Porter*, 186 F.2d 834 (9th Cir. 1950)].

In its oral decision the trial Court stated: "The regulation flatly says that sums of money expended for the promotion or defeat of legislation are not deductible from gross income . . . It is admitted in the record that the sums here in question were spent by taxpayers for the purpose of defeating the enactment of certain legislation by initiative *and that being so, those sums are not deductible from gross income . . .* But that has nothing whatever to do with whether the sums so spent by the taxpayer are deductible for income tax purposes. *In that matter the Regulation is controlling and clearly requires judgment in favor of defendant.*" (TR 29, 30) (italics ours).

In Conclusion of Law No. 2 the trial Court said: ". . . But it is perfectly clear that the payment to the Trust Fund was entirely for propaganda, and aimed at the defeat of legislation. *For both of these reasons, and without in any way condemning the stand taken in the campaign, the payment is not deductible under that Section, according to long standing Treasury Regulations . . .*" (TR 47-48) (italics ours).

Thus, the lower Court, in accordance with the determination of the Commissioner, held likewise that the Regulation barred the expenditures without need

for making any further determination whether otherwise the expenditures factually were "ordinary and necessary."

Thus the equivocal comments found in Finding No. 9, when viewed in the light of the record, show that the lower Court rested its determination solely on the ground of the Regulation without considering any alternate issue.

The second and alternate ground of the opinion based on Finding No. 9 is erroneous for an additional and even more conclusive reason:

Section 23(a)(1)(A) of the Revenue Code permits a taxpayer to deduct "All the ordinary and necessary expenses" incurred in carrying on a business.

The Regulation purports to block out and bar certain types of expenditures as non-deductible without right on the part of the taxpayer to show that in fact such expenditures otherwise are ordinary and necessary.

Thus, if the Regulation may be validly applied to certain expenditures, the issue whether such expenditures in fact are ordinary and necessary becomes moot and unnecessary for determination.

On the other hand, if it is held that the Regulation cannot be validly applied to certain expenditures, then of course the second issue, whether the expenditures are in fact ordinary and necessary, must be resolved in order to justify a deduction.

The second and alternate ground of the opinion holds—even though the lower Court decided that the

Regulation was valid as applied to the expenditures in question and even though it was therefore unnecessary for the disposition of the case to determine whether such expenditures were in fact ordinary and necessary—that the lower Court nevertheless resolved such issue by reason of Finding No. 9 and therefore the opinion holds that Appellants failed to sustain the burden of proof in that respect.

The opinion states that the judgment of the lower Court must be affirmed apart from the question of the validity of the Regulation because Finding No. 9 is a finding that Appellants failed to sustain the burden of proof “that the passage of the initiative would have impaired its business as a beer distributor.”

But such a finding is utterly without legal significance. The only prescribed issue that could be raised in the case—aside from the question of the validity of the application of the Regulation—is plainly the issue prescribed by the Code: whether the expenditures were “ordinary and necessary” in fact and whether Appellants did or did not meet the burden of proof on that issue.

A finding that Appellants failed to show that the enactment of the Initiative would have impaired their business certainly cannot be equated into a finding that Appellants failed to show that the expenditures were ordinary and necessary—the standard expressly provided for in the Code.

The Supreme Court in numerous decisions has defined the meaning of the words “ordinary and necessary.”

"Ordinary" means "the response ordinarily to be expected" from a business man, *Commissioner v. Heininger*, 320 U.S. 467, 471 (1943); *Welch v. Helvering*, 290 U.S. 111 (1933). Thus the test is subjective and prospective—not objective.

"Necessary" means "appropriate and helpful" to the business—not indispensable, *Commissioner v. Heininger*, supra, at p. 471; *Welch v. Helvering*, supra, at p. 113.

The holding of the opinion that a taxpayer must show his business is impaired in order to justify a deduction of expenditures is clearly an erroneous statement of the law. If such were the law most business expenses, of course, would not be deductible. On the contrary the only showing required of a taxpayer—if the question is placed in issue aside from any regulation—is a showing that the expenditures were "ordinary and necessary" within the meaning of the Code section. According to the Supreme Court cases defining those words, such a showing is entirely different and certainly in no way commensurate with any drastic requirement that a taxpayer must show that his business would have in fact been impaired.

The issue whether the expenditures are "ordinary and necessary" as prescribed by the Code and as defined by the Supreme Court decisions construing the Code, therefore, involves an entirely different standard than the narrow constricted standard and issue set forth in the opinion.

Hence, even if Finding No. 9 be construed in the manner stated in the opinion, it is without legal

significance because it contains no express finding that Appellants failed to show that the expenditures were "ordinary and necessary." The equivocal passing comment by the lower Court contained in Finding No. 9 cannot conceivably be construed as such a finding.

If the lower Court did pass on the issue whether the expenditures were in fact ordinary and necessary—which decision was unnecessary because the lower Court held the Regulation valid—then surely the lower Court should be required to make, and Appellants were entitled as of right to have the lower Court make: a clear cut finding that the Appellants failed to show the expenditures were in fact not "ordinary and necessary."

And in event such a finding were made, then Appellants should, of course, be afforded the right in both the lower Court and in this Court to attack such a finding as not supported by the evidence.

But Appellants have been denied that right in this case by reason of the alternate holding of the opinion. The Government in its brief on appeal nowhere raised or broached the point that Finding No. 9 should be construed as this Court has so construed it or that the expenditures in fact were not ordinary and necessary aside from the validity of the Regulation. Nor did Appellants, of course, so construe the Finding.

The contention that Finding No. 9 should be so construed was raised for the first time by this Court on its own initiative, in oral argument. Appellants were consequently caught by surprise.

Furthermore, the holding of the opinion in affirming the judgment of the lower Court on this second alternate ground is restricted solely to a construction of Finding No. 9 without any further consideration whatsoever of the question whether Appellants according to the record below failed to show that the expenditures were in fact "ordinary and necessary" and hence deductible.

On that issue Appellants urge that the record clearly shows that the expenditures were ordinary and necessary beyond question and as a matter of law.

The premises upon which that inescapable conclusion is based are as follows:

- (1) Appellants admittedly were beer wholesalers.
- (2) It follows that their customers must have been retailers otherwise Appellants could not have been wholesalers.
- (3) The court must take judicial notice of the fact that under the laws of Washington then existing, the State of Washington was not engaged in the retail distribution of beer. Appellants' customers, therefore, must have been private firms and persons.
- (4) Under the proposed Initiative all retail licenses of such private persons and firms would have been revoked and the retail sale of beer lodged exclusively in the State.
- (5) Thus, had the Initiative been enacted, Appellants would have been deprived of all their existing customers and their existing method of doing business would have been destroyed.

Therefore, to say that the business would not have been impaired—entirely aside from the judicial admission of Government counsel to that effect—and that the expenditures so made in preserving the existing business were not “ordinary and necessary” would be directly contrary to the interpretation which the Supreme Court has placed upon the meaning of those words.

*Commissioner v. Heininger*, 320 U.S. 467 (1943) is squarely in point. There a mail order dentist’s method of advertising through the mails was challenged by the Postmaster General. By reason of the imposition of a fraud order by the Postmaster General, taxpayer was prevented from advertising through the mails and thus from continuing his existing method of doing business. The Supreme Court in the strongest possible language held that the expenditures so incurred in defending taxpayer’s existing method of doing business were ordinary and necessary beyond question. Thus the Supreme Court said: “So far as appears from the record *respondent did not believe*, nor under our system of jurisprudence *was he bound to believe*, that a fraud order destroying his business was justified by the facts or the law. *Therefore he did not voluntarily abandon the business but defended it by all available legal means.* To say that this course of conduct and the expenses which it involved were extraordinary or unnecessary would be to ignore the ways of conduct and the forms of speech prevailing in the business world.” (p. 472) (italics ours).

The fact that the dentist in the *Heininger* case was free to procure customers by different methods or to practice dentistry in some different or other form, of course, was immaterial. So here, the fact that Appellants might engage in some other or different form of business is likewise immaterial. The crucial fact here is that Appellants would have lost all of their existing customers; their existing method of doing business would have been destroyed. Furthermore, it was not necessary for Appellants to actually show that the business in fact would have been affected. The crucial test is: did Appellants in making the expenditures respond as an ordinary business man would have responded under circumstances where he *believed* his existing method of doing business to be threatened. The *Heininger* case clearly shows that the test is purely a subjective test based upon reasonable belief in making the expenditures and that expenditures made under such circumstances are ordinary and necessary beyond question.

This topic dealing with the deductibility of "ordinary and necessary" business expenditures—apart from the Regulation—may now be summed up as follows:

(1) The basic issue is whether the expenditures are "ordinary and necessary" within the express language of §23(a)(1)(A).

The issue is not as stated in the opinion whether the business would have been impaired.

(2) Since the basic issue is whether the expenditures are "ordinary and necessary," the correlative finding must be stated in the same express language.

A finding, as stated in the opinion, that taxpayers have failed to show the business would have been impaired is not a finding on or in any way commensurate with the requisite basic finding and issue whether the expenditures are "ordinary and necessary." Therefore the finding referred to in the opinion is without legal significance.

(3) Proof that a taxpayer incurred expenditures in defending his existing method of doing business in the belief that his business might be impaired and that his response in so doing was the response ordinarily to be expected from a business man is a modicum of proof sufficient to show that the expenditures beyond question and as a matter of law are "ordinary and necessary."

The opinion is in error in referring to actual impairment of the business as the issue whereas it is only one of many avenues of evidence and proof available to a taxpayer and relevant to the basic issue whether the expenditures are "ordinary and necessary."

Furthermore, even as to proof of impairment of the business—which proof Appellants contend, in any event conclusively shows that the expenditures are "ordinary and necessary"—affirmative evidence is not required that the business in fact would have been impaired, as stated in the Court's opinion. The only proof required is proof that the taxpayer *reason-*

ably believed, in the manner of an ordinary business man, that his business would be impaired and hence incurred the expenditures in defending it. Such is the holding of the Supreme Court in the *Heininger* case.

Appellants are most desirous of having the issue of the validity of the Regulation as applied to the instant expenditures presented squarely to the Supreme Court, free from any collateral issue involved in this Court's holding with respect to Finding No. 9. The Court's conclusion with respect to Finding No. 9 admittedly, according to the opinion, is an alternate ground for the Court's decision and hence is not necessary to the Court's ultimate decision in the case.

Appellants respectfully urge that: (1) The Second and alternate ground of the opinion relating to Finding No. 9 be stricken because it clearly contains erroneous statements of law and further because it is an alternate and unnecessary ground in support of the decision; or in any event (2) that the case be remanded to the lower Court for further proceedings on the issue and formulation of a finding whether the expenditures in fact were ordinary and necessary apart from the Regulation.

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## V.

### REQUEST FOR REHEARING EN BANC.

Because of the importance of the decision in this case to the entire beer and brewing industry of the United States (the decision in this case being contrary

to the interpretation of the Regulation and practice heretofore followed by the Treasury in allowing as a deduction expenditures made under similar circumstances) and the importance of the decision to taxpayers in other industries similarly situated, and further because it is the purpose of Appellants to request the Supreme Court in any event to review any adverse decision in this case—for the purpose of clarifying the scope of the Regulation in light of the *Textile*, *Heininger*, and *Lilly* decisions of the Supreme Court—Appellants respectfully request not only that a rehearing be granted, but further that said rehearing be en banc.

Dated, San Francisco, California,  
August, 1957.

Respectfully submitted,

ATHEARN, CHANDLER & HOFFMAN,

WALTER HOFFMAN,

CLARK W. MASER,

JONES & GREY,

A. R. KEHOE,

HARGRAVE A. GARRISON,

*Attorneys for Appellants.*

**CERTIFICATE OF COUNSEL.**

I, Walter Hoffman, attorney for Appellants herein, do hereby certify that the foregoing petition for a rehearing and for a rehearing en banc is presented in good faith, is in my judgment well founded, and is not interposed for delay.

WALTER HOFFMAN.

(Appendix Follows.)







## Appendix

# UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WILLIAM B. CAMMARANO and LOUISE CAMMARANO, His Wife,  
vs.  
UNITED STATES OF AMERICA,

*Appellants,*

*Appellee.*

No. 15,350  
July 8, 1957

Appeal from the United States District Court for the Western District of Washington, Southern Division.

Before: ORR, POPE, and FEE, Circuit Judges  
RR, Circuit Judge:

Appellants, partners in a wholesale beer distributing concern in Tacoma, Washington, made a contribution to the Washington Beer Wholesalers Association, Inc., Trust Fund. The Trust Fund had been established December 17, 1947, to carry on an extensive state-wide publicity program, directed by an Industry Advisory Committee, on behalf of wholesale and retail beer and wine dealers to defeat proposed initiative legislation in the State of Washington. The measure, if enacted into law, would have placed the retail sale of wine and beer exclusively in state owned and operated stores.<sup>1</sup>

The Association assessed its members amounts based upon their volume of business. The funds received from the contributions,

<sup>1</sup>The ballot title of the Initiative provided:

"An Act prohibiting the retail sale of beer and wine by any person other than the State of Washington, repealing all provisions of existing law pertaining to licensing of retail sale of beer and wine, revoking existing licenses and providing penalties."

appellants' contribution included, were used in an effort to defeat the initiative legislation.

On their income tax returns appellants claimed a deduction for the contribution made as an ordinary and necessary business expense within the meaning of § 23(a)(1)(A), Internal Revenue Code of 1939.<sup>2</sup> The Commissioner of Internal Revenue disallowed this deduction on the ground that the contribution was used for lobbying purposes and the promotion or defeat of legislation, and therefore within the prohibition contained in Treasury Regulations 111, § 29.23(o)-1, in force and effect at the time the payment was made. Following payment of the assessed deficiency and a claim for refund, this suit for refund followed.

The regulation reads:

Sec. 29.23(o)-1. *Contributions or Gifts by Individuals.*—

\* \* \* \* \*

Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising and contributions for campaign expenses, are not deductible from gross income.

\* \* \* \* \*

The field encompassing the force and effect of the lobbying regulation set out above has often been plowed; but there exists no straight furrow which leads unerringly to the proper solution of all cases. The regulation has quite often been held to preclude deductions made for moneys spent to defeat legislation.<sup>3</sup> Of course, the particular facts of each case govern.

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<sup>2</sup>Sec. 23 DEDUCTIONS FROM GROSS INCOME

In computing net income there shall be allowed as deductions:

(a) **Expenses.**—

(1) **Trade or Business Expenses.**—

(A) **In General.**—All the ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business, \* \* \* \* .

<sup>3</sup>See *Textile Mills Corp. v. Commissioner*, 1941, 314 U.S. 326; *Sunseal Seavenger Co. v. Commissioner*, 9 Cir., 1936, 84 F.2d 453; *Revere Racing Assn. v. Seanlon*, 1st Cir., 1956, 232 F.2d 816; *American Hardware & Eq. Co. v. Commissioner*, 4 Cir., 1953, 202 F.2d 126, cert. denied 344 U.S. 814 (1953); *Roberts Dairy v. Commissioner*, 8 Cir., 1952, 195 F.2d 948, cert. denied, 344 U.S. 865 (1952).

Unquestionably the regulation is broad enough to exclude deductions for any and all sums spent for lobbying and the promotion or defeat of legislation, and the Government insists that the courts have sustained the validity of the regulation in that broad sense. The case of *Textile Mills Corp. v. Commissioner*, 1941, 314 U.S. 326, is relied on by the Government.<sup>4</sup> It is argued by appellants, with some force, that *Textile Mills*, as an authority, should be restricted to the facts of that particular case, and that the ban against deductions of amounts spent for lobbying as ordinary and necessary expenses is valid only where they arise from that family of contracts to which the law has given no mention." 314 U.S. at 339. However, other language in *Textile Mills* characterizes the words "ordinary and necessary" as used in the statute, as not being "so clear and unambiguous in their meaning and application as to leave no room for an interpretation of regulation." 314 U.S. at 338. We think it may reasonably be gathered from a reading of *Textile Mills* that the Commissioner, in segregating sums paid for lobbying as non-deductible ordinary and necessary business expenses, acted within the proper exercise of his rule-making power.

This court in the case of *Sunset Scavenger Co. v. Commissioner*, 9 Cir., 1936, 84 F.2d 455, decided prior to *Textile Mills*, held that an association of scavengers in San Francisco could not deduct expenses incurred in combatting an ordinance which could have seriously affected their business. In its decision this court relied on the doctrine of statutory re-enactment in the face of a known administrative interpretation to sustain the lobbying regulation, as well as the latent ambiguity of the phrase, "ordinary and necessary business expenses."

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<sup>4</sup>In *Textile Mills*, the Supreme Court held that the expenses of lobbying and propaganda, paid by a corporation employed by certain German textile interests to secure legislation from Congress authorizing the recovery of German properties seized during the First World War, were not deductible. The Court there related the lobbying regulation to ordinary and necessary business expenses, and rejected the contention that the limitation was not applicable to such expenses because it was intended as a regulation under § 23(n), Internal Revenue Code of 1939, but was not specifically included as a regulation under § 23(a) of the Act.

In *American Hardware v. Commissioner*, 4 Cir., 1953, 202 F.2d 126, cert. denied, 346 U.S. 814 (1953), the regulation was applied to disallow deductions for payments by a hardware company to the National Tax Equality Association, which issued propaganda on the subject of tax revision. The court there held that *Textile Mills* controlled, rejecting contentions that *Textile Mills* was limited to the non-deductibility of items which are against public policy or are morally wrong, and that the lobbying regulation was inapplicable to ordinary business expenses since not specifically appended to § 23(a).

In *Revere Racing Association v. Scanlon*, 1 Cir., 1956, 232 F.2d 816, the regulation was again applied to disallow payments by a dog racing company for the defeat of a public referendum on the question of whether pari-mutuel system of betting at dog races would be continued in the county. There, the court rejected the contention that the regulation was inapplicable where the measure was before the people upon referendum, rather than before a legislature.

Appellants cite *Commissioner v. Heininger*, 1943, 320 U.S. 467 and *Lilly v. Commissioner*, 1952, 343 U.S. 90, both decided subsequent to *Textile Mills*, as limiting the scope of *Textile Mills* to payments violating public policy.

In *Commissioner v. Heininger*, a mail order dentist was allowed a deduction as ordinary and necessary business expenses for legal fees incurred in an unsuccessful contest of a fraud charge lodged by the Postmaster. In *Lilly v. Commissioner*, an optician was allowed business expense deductions for kick-backs to a prescribing physician, where the practice was customary.

Those cases are distinguishable in that the regulation here involved was not applicable; there was no lobbying involved. In *Lilly v. Commissioner*, the Supreme Court expressly distinguished *Textile Mills* on the ground that in the earlier case an interpretative regulation had been in effect for many years with Congressional acquiescence. 343 U.S. at 95.

This court in *Sunset Scavenger v. Commissioner*, 9 Cir., 1938, 84 F.2d 453, held that the doctrine of statutory re-enactment in the face of a known administrative interpretation applied in that case. We think that doctrine can be said to apply with equal

orce in the instant case.<sup>5</sup> What we have said sustains an affirmance of the judgment, but there is also another reason which so requires an affirmance. The trial court found that:

"9. There was testimony to the effect that the Initiative, if passed, would have affected the wholesale business of Cammarano Brothers. However, the way in which the measure, aimed as it was at retail sales of wine and beer, would have affected the wholesale distribution of beer was not made clear. In any event, the measure was defeated."

This is a finding that appellants failed to sustain their burden of establishing by a preponderance of the evidence that the passage of the initiative would have impaired its business as a beer distributor.

Judgment Affirmed.

(Endorsed:) Opinion. Filed July 8, 1957.

Paul P. O'Brien, Clerk.

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<sup>5</sup>The lobbying regulation assumed its present form in Article 562 of Treasury Regulations 45 (1919 ed.), promulgated under the Revenue Act of 1918, and has since appeared without change, in all successive regulations. See Article 562 of Treasury Regulations 45 (1920 ed.), 62, and 69, promulgated under the Revenue Acts of 1918, 1921, 1924, and 26, Article 262 of Treasury Regulations 74 and 77 (1929 and 1937 ed.), promulgated under the Revenue Acts of 1928 and 1932, Article (o)-2 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, Article 23(q)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, Article 23(o)-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, Sections 19.23(o)-1, 23(o)-1, and 39.23(o)-1 of Treasury Regulations 103, 111, and 118, respectively, promulgated under the Internal Revenue Code of 1939, and section 1.162-15 of the proposed Income Tax Regulations under the Internal Revenue Code of 1954.



No. 15357

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United States  
Court of Appeals  
for the Ninth Circuit

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HANS S. HOLLANDER and CLEMENCE BLUM  
HOLLANDER,  
Petitioners,  
vs.  
COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of Record

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Petition to Review a Decision of the Tax Court  
of the United States

FILED

JAN 18 1957

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Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—1-18-57

PAUL P. O'BRIEN, CLERK



No. 15357

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United States  
Court of Appeals  
for the Ninth Circuit

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HANS S. HOLLANDER and CLEMENCE BLUM  
HOLLANDER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

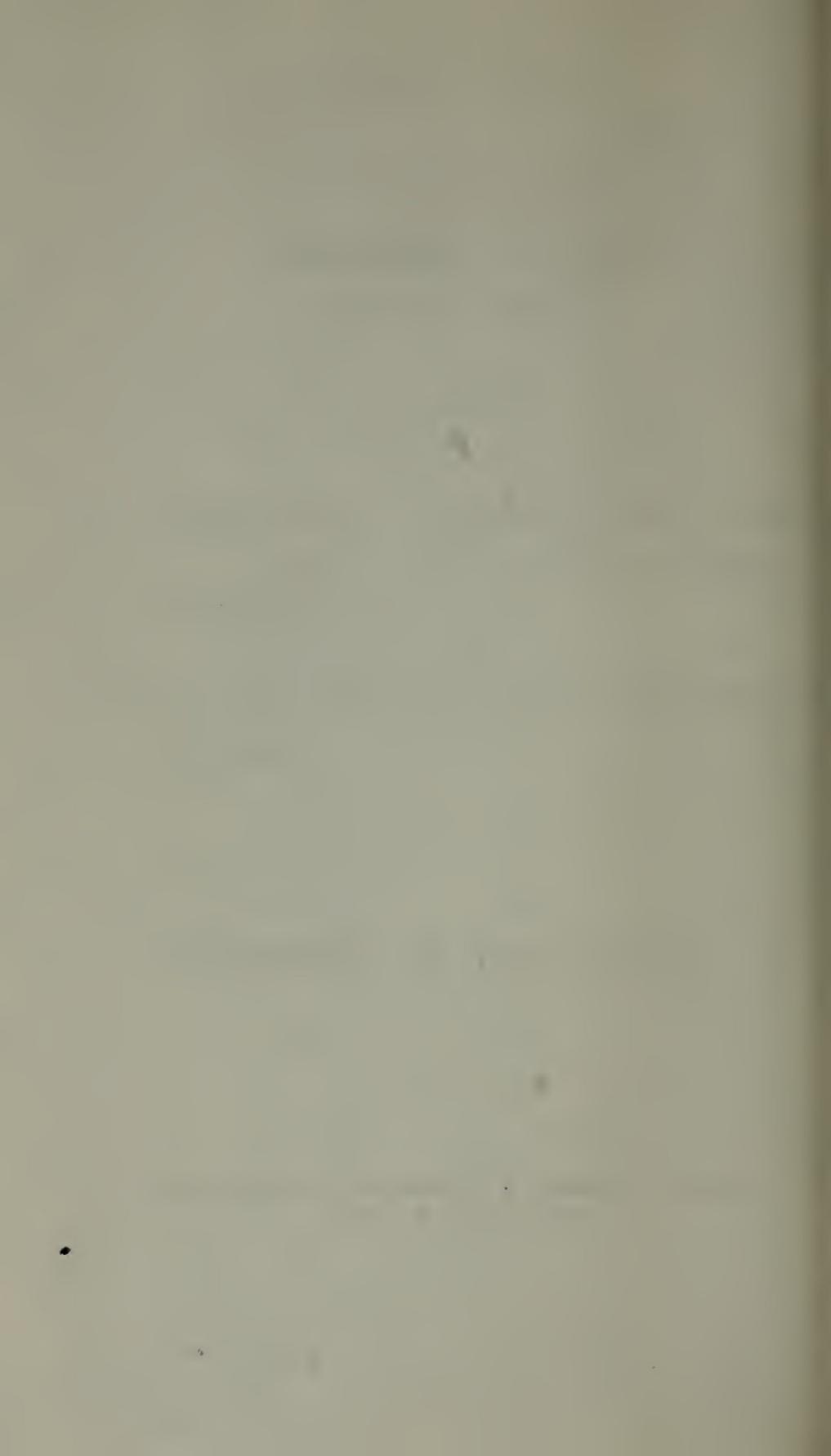
Respondent.

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Transcript of Record

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Petition to Review a Decision of the Tax Court  
of the United States



## INDEX

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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## APPEARANCES

LOUIS M. BROWN,  
EDWARD SANDERS,  
6399 Wilshire Blvd.,  
Los Angeles 48, Calif.,  
For Petitioners.

CHARLES K. RICE,  
Asst. U. S. Atty. General,  
Tax Div., Dept. of Justice;  
LEE A. JACKSON,  
Atty. Dept. of Justice,  
Department of Justice,  
Washington 25, D. C.,  
For Respondent.



The Tax Court of the United States

Docket No. 51365

HANS S. HOLLANDER and CLEMENCE  
BLUM HOLLANDER,

Petitioners.

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

**PETITION**

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols ANC-Ap-SF, LA: 90D:CTF) dated September 9, 1953, and as a basis of their proceeding allege as follows:

1. The petitioners are individuals, husband and wife, with their place of residence at 14 Flood Circle, Atherton, California. The returns for the petitioners here involved were filed with the Collector for the First District of California at San Francisco, California.
2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioners on September 9, 1953.
3. The deficiency as determined by the Commissioner is in income taxes for the calendar years 1948 and 1949, and is in the amounts of \$6,866.59 and \$3,947.58, respectively, of which \$2,680.30 for

1948 and \$3,481.04 for 1949, a total of \$6,161.34, is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

The Commissioner erred in determining that alimony payments by the taxpayer of \$5,292.60 in 1948 and \$7,867.44 in 1949 are not deductible under Internal Revenue Code Section 23(u).

5. The facts upon which the petitioners rely as the basis of this proceeding are as follows:

On March 6, 1946, petitioner Hans. S. Hollander entered into a property settlement agreement with his wife, Idy Hollander. Under the terms of this agreement, petitioner Hans S. Hollander was obligated to make payments to Idy Hollander for her support, care and maintenance until her death or remarriage. The 1946 property settlement agreement was incorporated in a decree of divorce granted by a Nevada court on June 12, 1946. Petitioner Hans S. Hollander complied with the provisions of said agreement at all times.

On March 16, 1948, the 1946 property settlement agreement was revised and modified with the consent of both parties. The 1948 modification obligated petitioner Hans S. Hollander to pay a different maximum amount of alimony annually for six years to his former wife, Idy Hollander. This obligation to pay alimony was to cease at the death

of Idy Hollander, and alimony payments made by petitioner in any year could not exceed 40% of his net income for that year. In any year where the latter limitation caused the amount of alimony paid to fall below the maximum amount of alimony due, the difference between the maximum amount of alimony due and the amount of alimony in fact paid was to be paid in later years. Moreover, payments in any later year also could not exceed 40% of petitioner's net income for that year. Thus, petitioner's obligation could extend over an indeterminate future period. Except for the specific changes made by the 1948 modification of agreement, all provisions of 1946 agreement remained in effect.

Payments by petitioner Hans S. Hollander under the 1948 agreement were payments in discharge of a legal obligation imposed by an instrument which was incident to both the original divorce decree and to the divorce itself. By merely modifying and revising the 1946 agreement, which had been incorporated in the original decree of divorce, the 1948 agreement was incident to both the original divorce decree and the divorce itself. Moreover, on June 30, 1948, the 1948 agreement was incorporated in a decree of a California Superior Court establishing the Nevada decree as a valid foreign judgment and ordering petitioner Hans S. Hollander to comply with its terms.

The payments made under the 1948 agreement

were periodic payments within the meaning of Internal Revenue Code Section 22(k).

No obligation the principal sum of which is specified exists in the 1948 agreement. The payments are to stop at the death of Idy Hollander and cannot exceed 40% of petitioner Hans S. Hollander's net income for any given year. Upon the death of petitioner Hans S. Hollander before February 1, 1951, his estate would be liable only for the maximum monthly payments falling due under the 1948 agreement between the date of his death and February 1, 1951. His estate would not be liable for the amount by which the maximum annual amount of alimony due exceeded 40% of his net income in years prior to his death. The existence of these contingencies makes the calculation of any specific principal sum impossible.

The 1948 agreement also provides that if in any given year a difference exists between the maximum amount of alimony and 40% of petitioner Hans S. Hollander's net income, such difference must be paid in later years. Since payments in any later year also may not exceed 40% of petitioner Hans S. Hollander's income for such year, petitioner Hans S. Hollander may be required to make payments for a period in excess of 10 years from the date of the 1948 agreement. This latter fact alone is enough to characterize the payments as periodic.

Wherefore, petitioners pray that this Court may hear the proceeding and redetermine the liability

therein complained of; that it determine that there is a deficiency due from the petitioners for years 1948 and 1949 which is not in excess of \$4,652.83; and that the Court may grant such other and further relief as the nature of the case may warrant.

/s/ LAWRENCE E. IRELL,  
Counsel for Petitioners.

Duly verified.

### EXHIBIT A

1250 Subway Terminal Building  
417 South Hill Street  
Los Angeles 13, California

Sep. 9, 1953

ARC-Ap:SF  
LA:90D:CTF

Mr. Hans S. Hollander and  
Mrs. Clemence Blum Hollander  
Husband and Wife  
25 West Clay Park  
San Francisco 21, California

Dear Mr. and Mrs. Hollander:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948, and December 31, 1949, discloses a deficiency of \$10,814.17, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute, in duplicate, the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

T. COLEMAN ANDREWS,  
Commissioner of Internal  
Revenue.

By /s/ W. T. TIGNOR,  
Associate Chief, Appellate  
Division.

CTForcum:vmc

Enclosures:

Statement  
Form 1276  
Agreement Form

Statement

ARC-Ap:SF  
LA:90D:CTF

Mr. Hans S. Hollander and Mrs. Clemence Blum Hollander  
Husband and Wife

25 West Clay Park, San Francisco 21, California

Tax Liability for the Taxable Years Ended  
December 31, 1948 and 1949

Year		Deficiency
1948	Income tax .....	\$ 6,866.59
1949	Income tax .....	3,947.58
	Total.....	\$10,814.17

In making this determination of your income tax liability careful consideration has been given to the reports of examination dated March 28, 1950, and November 6, 1951, to your protests dated August 15, 1950, and January 3, 1952, and to the statements made at the conference held on April 29, 1953.

In your returns for the taxable years 1948 and 1949 there are claimed deductions in the respective amounts of \$9,000.00 and \$7,867.44 for alimony paid. It has been determined under Section 23(u) of the Internal Revenue Code that a deduction of \$3,707.40 is allowable for 1948 and that no deduction is allowable for 1949. Accordingly, the deductions claimed are disallowed to the extent of \$5,292.60 for 1948 and \$7,867.44 for 1949.

A copy of this letter and statement has been mailed to your representative, Mr. Lawrence E. Irell, c/o Irell & Manella, 810

Roosevelt Building, Los Angeles 17, California, in accordance with the authorization contained in the power of attorney executed by you.

Adjustments to Net Income  
Taxable Year Ended December 31, 1948

Net income as disclosed by return.....	\$74,872.37
Unallowable deductions and additional income:	
(a) Alimony deduction disallowed .....	5,292.60
(b) Net gain from the sale or exchange of capital assets increased .....	6,750.00
(c) Travel and entertainment expense disallowed....	1,658.00
Net income adjusted .....	\$88,572.97

Explanation of Adjustments

(a) This adjustment has been previously explained herein.	
(b) The net gain from the sale of capital assets reported in your return in the amount of \$32,091.03 is increased in the amount of \$6,750.00 due to the following adjustments:	
(1) Capital loss carry-over disallowed.....	\$ 6,250.00
(2) Loss from sale of 500 shares of Blum's preferred deereased .....	500.00
Total.....	\$ 6,750.00

(1) It has been determined that the capital loss carry-over claimed in the amount of \$6,250.00 is unallowable, inasmuch as such loss resulted from the sale of a personal residence, and is not allowable under the provisions of the Internal Revenue Code.

(2) It has been determined that the cost or basis of 500 shares of Blum's preferred stock was \$9,000.00 instead of \$10,000.00, as shown in your return, or a decrease of \$1,000.00. The loss claimed is a long-term capital loss and the adjustment is, therefore, 50% of \$1,000.00, or \$500.00.

(c) Travel and entertainment expense claimed as a deduction in your return in the amount of \$4,975.00 is disallowed to the extent of \$1,658.00 due to lack of substantiation that such disallowed amount represents an allowable deduction under the provisions of the Internal Revenue Code.

Computation of Alternative Tax  
Taxable Year Ended December 31, 1948

Net income adjusted .....	\$88,572.97
Less: Excess of net long-term capital gain over net short-term capital loss .....	38,841.03
Ordinary net income .....	\$49,731.94
Less: Exemptions .....	3,000.00
Balancee subject to tax .....	\$46,731.94
One-half of \$46,731.94 .....	23,365.97
Tentative tax .....	\$ 9,185.92
Less reduction under Sec. 12(c), I.R.C.....	1,122.31
Partial tax on one-half of net income.....	\$ 8,063.61
Combined partial tax (\$8,063.61 x 2).....	\$16,127.22
Plus: 50 per cent of \$38,841.03.....	19,420.51
Combined alternative tax .....	\$35,547.73

Computation of Tax  
Taxable Year Ended December 31, 1948

Net income adjusted .....	\$88,572.97
Less: Exemptions .....	3,000.00
Balance, subject to tax .....	\$85,572.97
One-half of \$85,572.97 .....	42,786.48
Tentative tax .....	\$21,662.67
Less reduction under Sec. 12(c), I.R.C.....	2,619.52
Total tax on one-half of net income.....	\$19,043.15
Combined tax (\$19,043.15 x 2).....	38,086.30
Combined alternative tax .....	35,547.73
Correct income tax liability .....	35,547.73
Income tax liability shown on return, account No. 3198759 .....	28,681.14
Deficiency of income tax.....	\$ 6,866.59

Adjustments to Net Income  
Taxable Year Ended December 31, 1949

Net income as disclosed by return.....	\$32,305.48
Unallowable deductions:	
(a) Alimony deduction disallowed .....	7,867.44
(b) Travel and entertainment expense disallowed....	1,128.00

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Net income adjusted .....	\$41,300.92
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Explanation of Adjustments

- (a) This adjustment has been previously explained herein.
- (b) Travel and entertainment expenses claimed as a deduction in your return are disallowed to the extent shown below due to lack of substantiation that such disallowed amounts represent allowable deductions under the provisions of the Internal Revenue Code:

	Claimed	Allowed	Disallowed
Travel and entertainment expense required in earning salaries .....	\$3,685.00	\$2,457.00	\$1,228.00
Automobile expenses .....	1,200.00	900.00	300.00
Total.....			\$1,528.00
Additional expense allowed for trip to Europe .....	\$3,476.00	\$3,876.00	\$ 400.00
Net amount of travel and entertainment expense disallowed.....			\$1,128.00

Computation of Tax  
Taxable Year Ended December 31, 1949

Net income adjusted .....	\$41,300.92
Less: Exemptions .....	3,000.00
Balance subject to tax .....	\$38,300.92
One-half of \$38,300.92 .....	19,150.46
Tentative tax .....	\$ 6,809.74
Less reduction under Sec. 12(c), I.R.C.....	837.17
Total tax on one-half of net income.....	\$ 5,972.57

Combined tax (\$5,972.57 x 2).....	\$11,945.14
Correct income tax liability .....	\$11,945.14
Income tax liability shown on return, account No.	
3195574 .....	7,997.56
Deficiency of income tax .....	\$ 3,947.58

Received and filed November 30, 1953, T.C.U.S.

Served December 1, 1953.

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[Title of Tax Court and Cause.]

### ANSWER

The Commissioner of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayers, admits, denies and alleges as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the deficiencies determined by the respondent are in income taxes for the calendar years 1948 and 1949 in the amounts of \$6,866.59 and \$3,947.58, respectively. Denies the remaining allegations of paragraph 3 of the petition.

4. Denies the allegations contained in paragraph 4 of the petition.

5. Admits that on March 6, 1946, petitioner Hans S. Hollander entered into an agreement entitled "property settlement agreement" with his

wife Idy Hollander; that under the terms of this agreement petitioner Hans S. Hollander was obligated to make payments to Idy Hollander for alimony, care and maintenance until her death or remarriage; that this agreement was incorporated in a decree of divorce granted by a Nevada court on June 12, 1946; that petitioner Hans S. Hollander complied with the provisions of said agreement; and that on March 16, 1948, the parties entered into a second agreement under which petitioner Hans S. Hollander was obligated to pay a different maximum amount annually for six years to his former wife, Idy Hollander. Denies the remaining allegations of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ DANIEL A. TAYLOR, R.E.M.  
Chief Counsel, Internal  
Revenue Service.

Filed January 26, 1954, T.C.U.S.

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[Title of Tax Court and Cause.]

#### STIPULATION OF FACTS

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above-

entitled taxpayers, by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evidence of any such facts on the grounds of immateriality or irrelevancy.

### I.

Taxpayers, from and after August 5, 1948, were husband and wife. The taxpayers filed their Federal Income Tax Returns for the calendar years 1948 and 1949 with the Collector of Internal Revenue for the First District of California. The Returns were filed on the cash receipts and disbursements basis.

### II.

Hans S. Hollander was married to Idy Hollander on September 30, 1937. One child was born of said marriage, namely Barbara Mia Hollander, born August 12, 1940.

### III.

On March 6, 1946, in contemplation of divorce, a property settlement agreement was entered into by and between Hans S. Hollander and Idy Hollander. Under the terms of said property agreement, a copy of which is attached hereto, marked "Exhibit 1A," and incorporated by reference as if fully set out herein, Hans S. Hollander agreed to make certain payments for the support and maintenance of Idy Hollander.

## IV.

On or about June 12, 1946, Idy Hollander, then a resident of the State of Nevada, instituted divorce proceedings against Hans S. Hollander. On June 12, 1946, a decree of divorce was entered by the Nevada court, under the terms of which the aforesaid property settlement agreement of March 6, 1946, was made a part of the decree and the parties ordered to comply therewith. Thereafter, Hans S. Hollander performed all of his obligations under said agreement pursuant to said decree of said court.

## V.

On March 16, 1948, Hans S. Hollander and Idy Hollander entered into a second agreement. A true and correct copy of said agreement of March 16, 1948, is attached hereto, marked "Exhibit 2B," and incorporated by reference as if fully set out herein.

## VI.

The divorce obtained by Idy Hollander from Hans S. Hollander was not contested by Hans S. Hollander. Subsequent to such divorce, Idy Hollander made known to Hans S. Hollander the fact that she desired to remarry. The person whom Idy Hollander desired to marry was relatively impecunious. In addition, subsequent to the divorce, and because of various circumstances, Idy Hollander had not been able to keep the child, Barbara Mia Hollander, with her, and by mutual agreement said child had lived with Hans S. Hollander since No-

vember, 1946. Under the first property settlement agreement of March 6, 1946, which was incident to the decree of divorce, the terms provided that upon the remarriage of Idy, Hans would be relieved of further alimony obligations, said agreement further provided that Idy Hollander was to have custody of the said child. In order to enable the re-marriage of Idy Hollander and to obtain legal custody of the said child, Hans S. Hollander voluntarily entered into the second agreement of March 16, 1948.

## VII.

Idy Hollander remarried on March 29, 1948.

## VIII.

Subsequent to June 12, 1946, Idy Hollander had become a resident of the State of California. On or about May 18, 1948, an action was instituted by Hans S. Hollander in the Superior Court of the State of California in and for the County of Los Angeles, to establish the Nevada judgment of divorce as a foreign judgment. On June 30, 1948, the decree of the California court was entered. A true and correct copy of said decree is attached hereto, marked "Exhibit 3C," and incorporated by reference as if fully set out herein.

## IX.

Hans S. Hollander married Clemence Blum Hollander on or about August 5, 1948. Hans S. Hollander is presently a resident of Los Angeles, California, and Clemence Blum Hollander is presently a resident of San Francisco, California.

## X.

During the calendar year 1948, Hans S. Hollander made twelve monthly payments of \$550 apiece to his former wife, paid \$1,990.40 to the Federal Government on account of his former wife's liability for 1947 Federal income taxes and \$67 to the State of California on account of his former wife's liability for 1947 California income taxes. The aggregate amount of these payments was \$8,657.40. Taxpayers claimed the full amount of said payments as an alimony deduction on their 1948 income tax return. During the calendar year 1949, Hans S. Hollander made twelve monthly payments of \$550 apiece to his former wife, paid \$1,225.44 to the Federal Government on account of his former wife's liability for 1948 Federal income taxes, and \$42 to the State of California on account of his former wife's liability for 1948 California income taxes. The aggregate amount of these payments was \$7,867.44. Taxpayers claimed the full amount of said payments as an alimony deduction on their 1949 income tax return.

In connection with the amount claimed by taxpayers as an alimony deduction on their 1948 income tax return, the Commissioner of Internal Revenue allowed the following amounts:

\$2,057.40—representing amounts paid by Hans S. Hollander on account of his former wife's 1947 liability for Federal and California income taxes, and

\$1,650.00—representing three monthly payments of \$550 apiece made by Hans S. Hol-

lander during the first three months of 1948 to his former wife.

The balance of the amount claimed as an alimony deduction on taxpayers' 1948 income tax return was disallowed. The entire amount claimed by taxpayers as an alimony deduction on their 1949 income tax return was disallowed by the Commissioner of Internal Revenue.

/s/ EDWARD SANDER,  
Counsel for Petitioners.

/s/ R. P. HERTZOG, R.E.M.  
Acting Chief Counsel, Internal Revenue Service,  
Counsel for Respondent.

## EXHIBIT 1-A

### Property Settlement Agreement

This Agreement, made and entered into in the City of Los Angeles, County of Los Angeles, State of California, this 6th day of March, 1946, by and between Idy Hollander, hereinafter for convenience referred to as the "wife," and Hans S. Hollander, hereinafter for convenience referred to as the "husband,"

Witnesseth:

The husband and wife represent:

(a) That they were lawfully married in Phoenix, Arizona, September 30, 1937, and ever since said date have been, and are now, husband and wife;

- (b) That they have as a result of said marriage one minor child, namely, Barbara Mia Hollander, born August 12, 1940, hereinafter referred to as the "child";
- (c) That irreconcilable differences and controversies have arisen between them, both as to their marital relations and their property rights;
- (d) That the parties are now living separate and apart and are permanently separated, although, because of the housing shortage, the parties are continuing to reside in the same house, but are occupying separate and distinct quarters;
- (e) That they desire to make, on a fair and equitable basis, a permanent and final settlement and adjustment between themselves with regard to their assets, property and property rights and obligations for support and maintenance which each has or may have or owe to the other or to the minor child;
- (f) That a full and complete disclosure has been made on the part of each of them to the other as to their property holdings and debts.

Now, Therefore, it is hereby agreed that in consideration of the mutual promises, conditions, agreements, covenants and terms herein contained, each of the parties hereto promises and agrees as follows:

1. Until such time as a valid interlocutory decree of divorce, or a decree of separate maintenance may be entered, if any, and under the conditions

enumerated below, the husband shall make certain payments for the support, care, and maintenance of the wife:

(a) Until such time as the wife finds quarters outside of the house in which she now lives, no payments shall be made by the husband to the wife hereunder, but the husband will continue to pay for the support and maintenance of the wife and child as heretofore. The wife agrees to make reasonable efforts to find such quarters, both parties understanding that the present housing shortage may render this difficult.

(b) If the wife is able to find quarters for herself and the child outside of the house in which she now lives, the husband agrees to pay to the wife Seven Hundred Dollars (\$700.00) per month in lieu of the obligation referred to in subdivision (a) above during the period in which the wife resides outside of said house with the child. Out of this payment, the wife shall apply such sums as are reasonably necessary for the support, care, maintenance and education of the child. In addition to this sum, husband shall reimburse the wife for necessary bills incurred by the wife in providing for the child reasonable clothes, piano lessons and private schooling if used, and also for any extraordinary medical and dental expenses of the child.

(c) Any sums which may become payable under the provisions of (b) of this paragraph shall be

payable in advance on the 1st day of each month, and the first payment shall be due on the 1st day of the month immediately following the month in which such housing is secured, at which time the prorated portion of the moneys due for the portion of the last preceding month for which payment may be owing shall also be paid.

2. Upon entry of a valid interlocutory decree of divorce or decree of separate maintenance, the husband agrees to pay to the wife from and after the entry of said decree and in lieu of the payments referred to in paragraph 1 hereof, an amount equivalent to \$10,000.00 per year, payable at the rate of one-twelfth (1/12) of said amount per month, for alimony, support, maintenance and care of the wife and child; provided, however, that if the amount so payable is greater than one-third ( $\frac{1}{3}$ ) of the income received by the husband for the year concerned, then said yearly amount shall be reduced to an amount equivalent to said one-third ( $\frac{1}{3}$ ) of said income so received by the husband, which lesser sum shall likewise be payable one-twelfth (1/12) thereof for each month during the year concerned. If by reason of the income of the husband, the husband has overpaid the wife, then an adjustment shall be made to effect the correct amount payable, and for this purpose the husband shall have the right to withhold payments, or portions thereof, if it be necessary to effect the correct amount payable to the wife hereunder. In addition to the payments referred to in the second preceding

sentence, the husband shall reimburse the wife for necessary bills incurred by the wife in providing for the child reasonable clothing, piano lessons, and private schooling, if used (so long as the child is a minor), and also for any extraordinary medical and dental expenses of the child. Any payments under the provisions of this paragraph 2 shall commence immediately following the entry of said decree and shall continue from and after said date for the remainder of the wife's natural life, or until such time as she shall remarry. If the wife shall remarry, then immediately upon the occurrence of said remarriage, payments as set forth in this paragraph 2 shall automatically cease, but in the event of such remarriage the husband shall continue to pay for the support of the child so long as the child is a minor in an amount which shall be agreed upon by and between the parties hereto, or, if the parties cannot so agree, as determined by Court. In any event, payments provided for in this paragraph and in paragraph 1 hereof shall automatically cease and terminate upon the death of the husband. However, should there remain any payments due and unpaid upon the death of the husband, it is agreed that such payments shall become obligations of the estate of the husband. Out of the payments made to the wife as provided for in this paragraph 2, the wife shall apply such sums as are reasonably necessary for the support, care, maintenance and education of the child, and the wife now undertakes such support, care, mainte-

nance and education in a manner reasonably commensurate with that of a child in a home comparable to the home heretofore maintained by the parties. Out of the sums provided for in this paragraph 2 the wife shall pay all income taxes which may be assessed on account of the payments made under the provisions of this paragraph but in this connection the wife authorizes and directs the husband to withhold from the payments made under this paragraph 2 the amount necessary to pay such taxes and the husband agrees to utilize the amount so withheld in the payment, on behalf of the wife, of her said income taxes, but in this connection the husband shall be under no obligation to pay any amount on behalf of the wife on account of such taxes in excess of that withheld hereunder and the husband shall not be liable or responsible in the event that the amount so withheld and so paid shall not be sufficient to pay the full income taxes of the wife, it being the intention hereof that this procedure is followed as an accommodation to the wife and to assure the wife that the amount necessary for the payment of such taxes by the wife shall not be dissipated. In this connection, if the parties so agree, the husband may cause to be prepared the wife's tax return but all expenses relating to such preparation or otherwise in connection with the wife's taxes shall be borne solely by the wife.

3. There are presently in existence the following life insurance policies upon the life of the husband:

- (a) Policy #3861297 in the amount of \$24,000.00 with the John Hancock Life Insurance Company;
- (b) Policy #5890-P in the amount of \$15,000.00 with the John Hancock Life Insurance Company;
- (c) Policy #4030885 in the amount of \$2,700.00 with the John Hancock Life Insurance Company;
- (d) Policy #4030886 in the amount of \$8,011.00 with the John Hancock Life Insurance Company.

The husband does agree to make the wife (or in case of her death or remarriage, the child) the sole irrevocable beneficiary under the aforementioned life insurance policies (except that the child shall be the beneficiary as to \$5,000.00) and agrees to maintain the said policies and to pay the premiums thereon. The terms of payment under the aforementioned policies, i.e., by installments, lump sums, etc., shall be in the discretion of the husband if they are to be made to the child and the wife is dead, and shall be in the discretion of the wife if they are to be made to the wife or to the child while the wife is alive; however, if the wife shall have remarried, the investment of the proceeds shall be jointly agreed upon by her and the husband's personal representatives.

4. The wife shall have the care, custody and control of the child but the husband shall have the full right of visitation at reasonable hours but as often as the husband desires. The husband shall have the right, if he so desires, to have the care, custody and control of the child during so-called

vacation months (i.e., the summer months between regular school terms) and if the husband exercises such right (which he shall have the right to do with respect to such vacation periods as he desires, it being understood that failure of the husband to exercise such right with respect to any particular vacation period shall not be deemed a waiver of the husband's right to exercise such right with respect to a later vacation period), then the wife shall have full right of visitation at reasonable hours but as often as the wife desires. Neither party shall have the right to take the child out of the State of California without first obtaining the written consent of the other. If the wife leaves the State of California without the child and (except for causes beyond her reasonable control) remains away from the State in excess of a consecutive period of one (1) year, then permanent and full custody of the child shall go to the husband, subject to the right of full visitation by the wife at reasonable hours but as often as the wife desires. Upon the death of either party, either before or after his or her remarriage, if any, permanent and full custody of the child shall go to the other party hereto. The wife agrees to provide a good, normal and regular education for the child commensurate with the child's present social and economic standing and to furnish a nurse or maid at all times in which the wife has custody of the child hereunder. If the wife fails to furnish said education, nurse or maid the husband may furnish the same and deduct the expense of the same from the sums pay-

able to the wife pursuant to paragraphs 1 or 2 as the case may be. In the event that the wife desires to place the child in a boarding school, then the husband shall have the right to approve such boarding school and in the absence of such approval, the wife shall place the child in a school selected by the husband.

5. The wife does hereby assign, set over and sell to the husband as his sole and separate property all the wife's interest in and with respect to the residence of the parties hereto located at 9101 Hazen Drive, Beverly Hills, California, as well as all furniture, furnishings and equipment contained in said residence and the wife agrees to execute the necessary deeds and bills of sale to effect such transfer. In full consideration of said transfer and of the rights granted by the wife to the husband under the provisions of this paragraph 5, the husband agrees to pay concurrently with the execution hereof the sum of Ten Thousand Dollars (\$10,000.00).

6. The parties hereto agree that all of the clothing, jewelry, and personal effects of the wife, and the Studebaker automobile in her possession shall be retained by the wife as her separate property, and the husband does hereby release and relinquish, assign, transfer and set over to the wife as her sole and separate property each and all of the items referred to in this paragraph.

7. All of the earnings of either or both of the husband and wife (except the earnings and accumu-

lations of the wife while she is living separate from the husband) shall be community property of the parties until entry of a valid interlocutory decree of divorce, if any. The husband agrees to pay all income taxes on the past and future community income and to indemnify the wife against liability therefor. Upon entry of such decree, the subsequent earnings of each party shall be the separate property of the party earning the same.

8. It is agreed that all of the rest and remainder of the property of the parties, except as hereinabove set forth, is and shall be deemed to be the separate property of the husband.

9. The husband and wife do hereby release, acquit, and forever discharge the other from any and all claims which he or she now has or may hereafter have against or upon the other for payment of maintenance or alimony excepting as herein provided. Each of the parties hereto agrees that he or she will not under any circumstances ask any court in any divorce or separate maintenance action or otherwise for any allowance for alimony, support and maintenance or for any decree, judgment or order affecting the property rights of the parties hereto other than as provided and set forth in this agreement.

10. The partes hereto will forthwith execute, acknowledge and deliver any and all deeds, bills of sale, assignments or other instruments necessary or proper to carry into effect the stipulations, terms and provisions herein contained.

11. Each of the parties hereto waives, renounces and relinquishes all right to administer upon the estate of the other hereto at the death of the said other party, hereby agreeing to forego any and all rights that either may have to inherit from the other or to administer upon the estate of the other or to secure any homestead upon or from the estate of the other or family allowance. Nothing herein contained, however, shall affect the provisions of any will or testamentary disposition made by either party hereto in favor of the other.

12. It is agreed between the parties that should the wife be caused to retain legal counsel to enforce any of the provisions of this agreement or any order of any court of competent jurisdiction made pursuant thereto, that if the wife prevails in said proceedings the husband will pay to the wife in addition to the payments in this agreement otherwise provided to be made, such further and additional sums as may be reasonable for attorney's fees.

13. Neither of the parties hereto shall interfere with the other in his or her personal liberty, conduct or action; each of the parties agrees that the other at any and all times may live separate and apart, may reside at such places and may follow and carry on such business, occupation or profession as he or she may choose to the end that each of the parties shall hereafter have a full and independent liberty, freedom of action and conduct

insofar as their mutual obligations, duties and responsibilities are concerned.

14. Each of the parties agrees and promises to incur no indebtedness or obligation of any kind or character whatsoever subsequent to the execution of this agreement which shall be a charge against the other.

15. It is agreed that if any paragraph, subparagraph, sentence, clause or phrase of this agreement is for any reason void or unenforceable, such portion of this agreement shall not affect the validity of the remaining portions thereof.

16. It is agreed that the terms and provisions of this agreement shall inure to and be binding upon the heirs, executors and legal representatives of the parties.

17. It is further expressly understood that although this agreement does not have as its object the dissolution of the marriage contract of the parties or the facilitating of that result and is intended solely as an adjustment of the property rights of the parties, this agreement may be submitted to a court of competent jurisdiction acquiring jurisdiction of the parties for its approval and the terms thereof may be incorporated in and enforced by any Decree of Divorce or Separate Maintenance or other order hereafter obtained by either of the parties hereto in lieu of any provision of a similar nature by the court in such decree or order.

18. Time is of the essence of this agreement.

19. The parties hereto acknowledge that they have carefully read this agreement and have each engaged attorneys to advise them in the premises, and that they understand each and every provision thereof, that said agreement is fair and just in all its particulars and that they enter into the same respectively of their free and voluntary will.

In Witness Whereof, the parties hereto have hereunto subscribed their names the day and year first above written.

/s/ IDY HOLLANDER,  
Wife.

/s/ HANS S. HOLLANDER,  
Husband.

I, H. F. Birnbaum, hereby certify that the within is a true and correct copy of the property settlement agreement between Idy Hollander and Hans S. Hollander, dated March 6, 1946.

[Seal] /s/ H. F. BIRNBAUM,  
Notary Public in and for the County of Los Angeles, State of California.

My commission expires March 17, 1950.

## EXHIBIT 2-B

### Agreement

This Agreement made and entered into in the City of Los Angeles, County of Los Angeles, State

of California, this 16th day of March, 1948, by and between Idy Hollander, hereinafter for convenience referred to as the "First Party," and Hans S. Hollander, hereinafter for convenience referred to as the "Second Party,"

Witnesseth:

Whereas, the parties hereto were heretofore married and were legally divorced on the 12th day of June, 1946, in the Eighth Judicial District Court of the State of Nevada in and for the County of Clark, and,

Whereas, prior to said decree the parties entered into a Property Settlement Agreement dated March 6, 1946, which Property Settlement Agreement was referred to under the provisions of said decree and was incorporated therein and was ratified and confirmed, and,

Whereas, said Property Settlement Agreement provides for certain payments to be made by Second Party to First Party until such time as First Party remarries and not thereafter and provides that the child of the parties, to wit: Barbara Mia, shall remain in the custody of the First Party with the rights of visitation and other rights in the part of Second Party, and,

Whereas, by reason of various circumstances First Party has not been able to keep said child with her and by mutual agreement since the divorce of the parties hereto said child has been and now is with the Second Party, and,

Whereas, pursuant to said Property Settlement Agreement, Second Party has paid to First Party continuously the sum of Five Hundred Fifty Dollars (\$550) per month, representing the net amount payable to First Party under said Agreement after the withholding of taxes and withholding the amount of salary payable for the services of the child's nurse pursuant to the Agreement of the parties hereto, and,

Whereas, First Party desires to remarry, but nevertheless desires that said payments be continued to be made by Second Party to First Party after such remarriage for a period of time, notwithstanding the provisions of said Property Settlement Agreement in said decree, and Second Party is willing to continue to make such payments upon conditions hereinafter set forth, and,

Whereas, the parties hereto desire that certain revisions be entered into in said Property Settlement Agreement,

Now, Therefore, It Is Agreed as Follows:

1. Notwithstanding the provisions of said Property Settlement Agreement, and in settlement of Second Party's obligations for alimony under said Property Settlement Agreement, Second Party will continue to pay to First Party the sum of Five Hundred Fifty Dollars (\$550) per month on the first day of each and every month, beginning with the first day of March, 1948, and continuing to and including the first day of February, 1951, and shall

pay to First Party the sum of Two Hundred Fifty Dollars (\$250) per month from the first day of March, 1951, until the first day of February, 1954. Said payments shall continue as provided in this paragraph notwithstanding the fact that the First Party remarries at any time hereafter, and should Second Party die prior to February 1, 1951, said payments shall continue until February 1, 1951, and shall be payable by the estate of Second Party as herein provided until said first day of February, 1951, and not thereafter. Should Second Party die between February 2, 1951, and February 28, 1954, said payments shall cease on the date of his death. Said payments shall cease upon the death of First Party. Whether or not First Party remarries, the obligations of Second Party to First Party to make payments under this agreement or under said agreement of March 6, 1946, or otherwise, shall cease with the payment to be made on February 1, 1954, or on the date of the death of the First Party, whichever event earlier occurs. In the event that the amount payable pursuant to this paragraph exceeds forty per cent (40%) of Second Party's income (defined as the moneys earned by Second Party, either as salary, dividends or bonuses or otherwise) during any year for which such payments are to be made hereunder (and for this purpose each year beginning March 1 shall be deemed the accounting period) then the amount to be paid by Second Party to First Party shall be reduced to said forty per cent (40%) of said income so earned by Second Party. For this purpose Second

Party may estimate his income at any time and may make payments at a reduced amount if by reason of his income it appears that such reduction may be made, and at the end of the calendar year concerned, an adjustment shall be made between the parties (except that First Party shall not be required to refund any moneys to Second Party) to the end that Second Party has paid during the year concerned the amount which he is obligated to pay pursuant to the provisions of this paragraph. If by reason of the provisions of this paragraph, First Party receives less than the amount provided to be paid First Party by Second Party in the first sentence of this paragraph, then First Party shall be entitled to receive any such deficiency at any time thereafter provided the amount earned by Second Party under the formula hereinabove set forth is sufficient to permit Second Party to make such payment covering such deficiency to First Party. For the purpose of illustration only, if at the end of the third year by reason of the formula hereinabove provided there is Two Thousand Dollars (\$2,000) that was not paid to First Party of the amount payable by Second Party to First Party, and if Second Party has no income for the following four years, but in the fifth year has an income of Four Thousand Dollars (\$4,000), then Sixteen Hundred Dollars (\$1,600) (40% of \$4,000) shall be payable during said year at the rate of one-twelfth (1/12) of the amount each month. There still would be a deficiency of Four Hundred Dollars (\$400), plus any other deficiency which might

have occurred during the fourth, fifth or sixth years of this agreement, and this deficiency would be payable similarly, depending upon the income of Second Party. It is further understood and agreed that one of the important considerations moving Second Party to make payments to First Party during the fourth, fifth and sixth years hereof at the rate of Two Hundred Fifty Dollars (\$250) per month, is the fact that the child of the parties is now remaining with Second Party. Payments for said fourth, fifth and sixth year shall cease if and when continuous custody is given to the First Party during or prior to the commencement of said third, fourth or fifth years, and First Party from and after said date waives any claim to such payments pursuant to the provisions of this paragraph. The obligation of the Second Party to make payments to the First Party pursuant to the provisions of this paragraph are in settlement of the obligations of Second Party to support First Party pursuant to the provisions of Paragraph 2 of the Property Settlement Agreement dated March 6, 1946. In consideration of the Second Party's agreement to make payments under this agreement notwithstanding the remarriage of First Party, the provisions of Paragraph 2 of the Property Settlement Agreement dated March 6, 1946, are hereby cancelled and terminated and shall have no force or effect whatsoever, it being expressly understood and agreed that the sole obligation on the part of Second Party to First Party for support, alimony and/or mainte-

nance by reason of the prior marriage between the parties hereto shall be as set forth in this agreement which shall supersede and take the place of the provisions of said Paragraph 2 of said Property Settlement Agreement. First Party does hereby waive any claim for support, maintenance, or otherwise except as in this agreement provided and does release Second Party of any other claims, demands and causes of action of any kind or character except as provided in this agreement. In the event the payments made to First Party pursuant to the provisions hereof are held to be taxable to First Party under the Income Tax Laws of the State or Federal Government, then Second Party shall pay such taxes to such governmental authorities for First Party. The obligations on the part of Second Party to defray such income tax obligations of First Party shall be limited to the amount which would be assessable to First Party if the payments made by Second Party to First Party pursuant to the provisions hereof were the only income of the First Party.

2. The parties hereto acknowledge that the child of the parties, Barbara Mia, has by mutual agreement remained with the Second Party since November, 1946. First Party acknowledges that at present the best interests and welfare of said child are served by said child remaining with Second Party, and agrees that until such time as First Party feels that the surroundings of said child with Second Party have changed to the detriment of the in-

terests and welfare of said child, said child shall remain with Second Party, but with full rights of visitation by First Party. In the event that at any time hereafter by reason of the changed circumstances as above provided First Party demands that said child from that time forward shall remain with First Party, and if Second Party claims that the removal of said child as demanded by First Party is not in the best interests and welfare of said child, then said matter shall be submitted for decision by a recognized child psychiatrist licensed as a specialist in this field. Said child psychiatrist shall be a Doctor of Medicine (M.D.), and if the parties cannot agree on a particular child psychiatrist, the same shall be referred to the appropriate court having jurisdiction for the purpose of appointing such child psychiatrist. The expenses of such submission shall be borne by the Second Party. It is not intended by the provisions hereof to deprive any court having appropriate jurisdiction of such matter of such jurisdiction, but this agreement is entered into because both parties recognize that the child's welfare is of the highest importance. Neither party shall have the right to take the child out of the State of California without first obtaining the written consent of the other. In the event of the death of either party, sole custody shall be in the other. During such time as the said child is lawfully with First Party, Second Party shall, in addition to such other obligations as he may have pursuant to the provisions hereof, pay for the support of said child in the amount of One Hundred

Fifty Dollars (\$150) per month, together with an additional amount necessary to provide clothing, private schooling expenses and extraordinary medical expenses for said child. Whenever said child is in the care and custody of one parent, the other parent shall at all times have the right of reasonable visitations. In the event that at such time, if any, that the First Party is entitled to custody of the child hereunder, and said First Party desires to place said child in a private school, then the Second Party shall have the right to approve such private school, and in the absence of such approval First Party shall place the child in the school selected by Second Party. The provisions of this paragraph shall be and be deemed to be in substitution for the provisions of Paragraph 4 of said Property Settlement Agreement which provisions of Paragraph 4 are and shall be deemed to be cancelled.

3. Second Party shall continue to maintain the life insurance policies upon the life of Second Party which are referred to in Paragraph 3, except that said policies shall provide that in the event of death of Second Party, there shall be paid to First Party for the sole benefit of said Barbara Mia, and so long as she is a minor and is living with and supported by First Party, the sum of Five Hundred Dollars (\$500) per month. The payments provided in this paragraph to be made shall, however, not commence until the completion of the payments to be made by Second Party to First Party pursuant to the provisions of Paragraph 1 hereof. In addition to said

sum of Five Hundred Dollars (\$500) per month, referred to in this paragraph, expenses of clothing, extraordinary medical care and private schooling shall be supplied for said child so long as she is a minor and is living with and supported by First Party.

4. As further consideration of the agreements of First Party, Second Party has concurrently herewith paid to First Party the sum of Six Hundred Dollars (\$600), receipt of which is hereby acknowledged. In addition, Second Party has paid to Milton Wichner the sum of Two Hundred Fifty Dollars (\$250), and agrees to pay the additional sum of Two Hundred Fifty Dollars (\$250) to said Milton Wichner on or before June 1, 1948. Said payment of Five Hundred Dollars (\$500) shall be deemed to be the full payment to be made on account of attorney's fees incurred by First Party in connection with the negotiation and execution of this agreement and the approval thereof by a court of competent jurisdiction as herein contemplated. Second Party shall not be called upon to make any further payments on account of First Party's attorney's fees in connection with said matters.

5. Nothing in this agreement contained shall be deemed to modify or affect said decree of divorce between the parties hereto except only as each party hereto agrees to certain modifications of said Property Settlement Agreement, which modifications do not and shall not be deemed to affect the divorce

of the parties and the termination of their marital status pursuant to said decree. Except as herein specifically set forth, said Property Settlement Agreement dated March 6, 1946, between the parties hereto is and shall be and remain in full force and effect.

6. It is understood and agreed that each of the parties hereto have been advised of their rights hereunder, First Party by her attorney, Milton Wichner, and Second Party by his attorneys, Prinzmetal & Grant. It is agreed that this agreement may be submitted by either party hereto to any court of competent jurisdiction for approval and that the same may be incorporated in any order or decree by such Court. If any part of this agreement is invalid or unenforceable such part shall not affect or impair any of the other provisions hereof.

In Witness Whereof, the parties hereto have hereunto set their hands the day and year first hereinabove set forth.

/s/ IDY HOLLANDER,  
First Party;

/s/ HANS S. HOLLANDER,  
Second Party.

## EXHIBIT 3-C

(Copy)

In the Superior Court of the State of California  
in and for the County of Los Angeles

No. SMC 1910

HANS S. HOLLANDER,

Plaintiff,

vs.

IDY HOLLANDER MARESCH,

Defendant.

ORDER ESTABLISHING JUDGMENT OF  
DIVORCE SECURED IN SISTER STATE  
AND APPROVING AGREEMENT FOR  
ALIMONY, CUSTODY, ETC.

This cause came on to be heard before Honorable Stanley Mosk, Judge Presiding in Santa Monica, Department A, on the 30th day of June, 1948, I. H. Prinzmetal of Prinzmetal & Grant appearing as attorney for the plaintiff, the defendant having filed a Notice of Appearance through her attorney, Milton Wichner, and no answer having been filed by the defendant, and the default of the defendant having been duly entered and the parties hereto having filed a Stipulation consenting to the entry of this Order,

It Is Ordered, Adjudged and Decreed:

- (1) That the judgment of divorce rendered by the Eighth Judicial District of the State of Nevada

in and for the County of Clark be established as a foreign judgment and that the same be enforced in this action subject to modifications as herein set forth;

(2) That the agreement between the parties dated March 16, 1948, be and the same is hereby ratified, confirmed and approved and the plaintiff is ordered to make payments to the defendant pursuant to said property settlement agreement.

(3) It Is Further Ordered, Adjudged and Decreed that until the further order of the Court the Plaintiff be and he is hereby awarded the care, custody and control of Barbara Mia Hollander, the minor child of the parties hereto but with full rights of visitation by the defendant.

Done in Open Court this 30th day of June, 1948.

STANLEY MOSK,  
Judge.

Filed at hearing April 26, 1955.

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[Title of Tax Court and Cause.]

#### FINDINGS OF FACT AND OPINION

Petitioner and Idy Hollander were divorced in June, 1946. Two months prior thereto, they entered into an agreement of permanent and final settlement with regard to their property and obligations for support and maintenance, which each had or

owed to the other, and this agreement was "ratified, confirmed and approved" in the decree of divorce. Under the agreement, Idy was to receive alimony payments for the remainder of her life or until her remarriage, and in the latter event, the payments were to cease automatically. In 1948, Idy advised petitioner that she desired to remarry. The man she desired to marry was "relatively impecunious," and "in order to enable" her to remarry, petitioner entered into a new agreement with her, whereunder, notwithstanding the limitations of the first agreement, petitioner agreed to make specified monthly payments to Idy subsequent to her remarriage. Idy was married within two weeks of the execution of the latter agreement. Held, that the payments made to Idy subsequent to her remarriage were not made under a written agreement incident to the divorce of petitioner and Idy, within the meaning of section 22 (k) of the Internal Revenue Code of 1939, but under an agreement incident to Idy's remarriage, and that the said payments are not, therefore, deductible by petitioners under section 23 (u) of the Code.

EDWARD SANDERS, ESQ.,  
For the Petitioners.

RICHARD W. JANES, ESQ.,  
For the Respondent.

Respondent determined deficiencies in income tax against petitioners for the taxable years 1948 and 1949 in the respective amounts of \$6,866.59 and

\$3,947.58. The question is whether certain payments made by Hans S. Hollander in 1948 and 1949 to his former wife are deductible by him and his present wife under section 23 (u) of the Internal Revenue Code of 1939. No witnesses being called, the proceeding herein was submitted on certain documentary evidence and facts stipulated by the parties.

### Findings of Fact

The facts which were stipulated are found as stipulated.

Petitioners are and have been since August 5, 1948, husband and wife. They filed their income tax returns for the years 1948 and 1949 with the collector of internal revenue for the first district of California.

Hans S. Hollander, sometimes referred to as petitioner, was married to Idy Hollander on September 30, 1937. One child, Barbara Mia Hollander, was born of the marriage, on August 12, 1940.

On March 6, 1946, in contemplation of divorce, an agreement was entered into by and between the petitioner and Idy Hollander, which agreement was declared to be a permanent and final settlement of property or property rights and obligations for support "which each has or may have or owe to the other or to the minor child." Under the terms of the agreement petitioner agreed to make certain payments for the support and maintenance of Idy Hollander. The agreement was in part as follows:

## Property Settlement Agreement

This Agreement, made and entered into in the City of Los Angeles, County of Los Angeles, State of California, this 6th day of March, 1946, by and between Idy Hollander, hereinafter for convenience referred to as the "wife," and Hans S. Hollander hereinafter for convenience referred to as the "husband,"

Witnesseth:

The husband and wife represent:

\* \* \*

(e) That they desire to make, on a fair and equitable basis, a permanent and final settlement and adjustment between themselves with regard to their assets, property and property rights and obligations for support and maintenance which each has or may have or owe to the other or to the minor child;

\* \* \*

2. Upon entry of a valid interlocutory decree of divorce or decree of separate maintenance, the husband agrees to pay to the wife from and after the entry of said decree and in lieu of the payments referred to in paragraph 1 hereof, an amount equivalent to \$10,000.00 per year, payable at the rate of one-twelfth (1/12) of said amount per month, for alimony, support, maintenance and care of the wife and child; provided, however, that if the amount so payable is greater than one-third (1/3) of the income received by the husband for

the year concerned, then said yearly amount shall be reduced to an amount equivalent to said one-third (1/3) of said income so received by the husband, which lesser sum shall likewise be payable one-twelfth (1/12) thereof for each month during the year concerned. If by reason of the income of the husband, the husband has overpaid the wife, then an adjustment shall be made to effect the correct amount payable, and for this purpose the husband shall have the right to withhold payments, or portions thereof, if it be necessary to effect the correct amount payable to the wife hereunder. In addition to the payments referred to in the second preceding sentence, the husband shall reimburse the wife for necessary bills incurred by the wife in providing for the child reasonable clothing, piano lessons, and private schooling, if used (so long as the child is a minor), and also for any extraordinary medical and dental expenses of the child. Any payments under the provisions of this paragraph 2 shall commence immediately following the entry of said decree and shall continue from and after said date for the remainder of the wife's natural life, or until such time as she shall remarry. If the wife shall remarry, then immediately upon the occurrence of said remarriage, payments as set forth in this paragraph 2 shall automatically cease, but in the event of such remarriage the husband shall continue to pay for the support of the child so long as the child is a minor in an amount which shall be agreed upon by and between the parties hereto, or, if the parties cannot so agree, as determined by

Court. In any event, payments provided for in this paragraph and in paragraph 1 hereof shall automatically cease and terminate upon the death of the husband. \* \* \*

\* \* \*

9. The husband and wife do hereby release, acquit, and forever discharge the other from any and all claims which he or she now has or may hereafter have against or upon the other for payment of maintenance or alimony excepting as herein provided. Each of the parties hereto agrees that he or she will not under any circumstances ask any court in any divorce or separate maintenance action or otherwise for any allowance for alimony, support and maintenance or for any decree, judgment or order affecting the property rights of the parties hereto other than as provided and set forth in this agreement.

On or about June 12, 1946, Idy Hollander, then a resident of Nevada, instituted divorce proceedings against petitioner. Petitioner did not contest the proceeding and on June 12, 1946, a decree of divorce was entered by the Nevada court, under the terms of which the agreement of March 6, 1946, was made a part of the decree, and the parties were ordered to comply therewith. Thereafter petitioner performed all of his obligations under the said agreement pursuant to the decree of the court. The decree of divorce was as follows:

## Decree of Divorce

The above-entitled action coming on regularly for trial before the above-entitled Court, without a jury, on the 12th day of June, 1946, plaintiff appearing in person and by her attorneys, Jones, Wiener and Jones, and the defendant having made a general appearance by and through his attorney, Oscar W. Bryan, and having filed an Answer and waived the right to findings of fact and conclusions of law and consenting to the trial of the above-entitled action, and the Court having heard and duly considered the evidence, and good cause appearing therefor;

It Is Ordered, Adjudged and Decreed that the bonds of matrimony now and heretofore existing between the plaintiff and defendant be, and the same are hereby dissolved, set aside, and held for naught, and the parties restored to their single status.

It Is Further Ordered, Adjudged and Decreed that the property settlement agreement of the 6th day of March, 1946, be, and the same is hereby ratified, confirmed and approved by this Court and made a part of this decree.

It Is Further Ordered, Adjudged and Decreed that the parties hereto comply with all the requirements contained in the above-mentioned property settlement agreement.

It Is Further Ordered, Adjudged and Decreed that the Court hereby retains jurisdiction of this

action and the parties hereto for the purpose of making such other and further order as may be just and proper for the custody, support and maintenance of the minor child of the parties, to wit, Barbara Mia Hollander, over whose care, custody and control there is no controversy at this time.

Dated this 12th day of June, 1946.

A. S. HENDERSON,  
District Judge.

In 1948, Idy "made known" to petitioner "the fact that she desired to remarry." The man whom she desired to marry was "relatively impecunious." Although granted custody of the daughter, Barbara Mia, Idy, due to "various circumstances," had not kept the child with her but, by mutual agreement, the child had lived with petitioner after November, 1946. Notwithstanding the provision of the first agreement that the alimony payments thereunder were to cease automatically in the event of Idy's remarriage, petitioner, "In order to enable the re-marriage of Idy Hollander and to obtain legal custody of the said child \* \* \* voluntarily entered into" a second agreement under date of March 16, 1948, which, in part, was as follows:

Whereas, the parties hereto were heretofore married and were legally divorced on the 12th day of June, 1946, in the Eighth Judicial District Court of the State of Nevada in and for the County of Clark, and,

Whereas, prior to said decree the parties entered into a Property Settlement Agreement dated March 6, 1946, which Property Settlement Agreement was referred to under the provisions of said decree and was incorporated therein and was ratified and confirmed, and,

Whereas, said Property Settlement agreement provides for certain payments to be made by Second Party to First Party until such time as First Party remarries and not thereafter and provides that the child of the parties, to wit: Barbara Mia, shall remain in the custody of the First Party with the rights of visitation and other rights in the part of Second Party, and,

\* \* \*

Whereas, First Party desired to remarry, but nevertheless desires that said payments be continued to be made by Second Party to First Party after such remarriage for a period of time, notwithstanding the provisions of said Property Settlement Agreement in said decree, and Second Party is willing to continue to make such payments upon conditions hereinafter set forth, and,

Whereas, the parties hereto desire that certain revisions be entered into in said Property Settlement Agreement,

Now, Therefore, It Is Agreed as Follows:

1. Notwithstanding the provisions of said Property Settlement Agreement, and in settlement

of Second Party's obligations for alimony under said Property Settlement Agreement, Second Party will continue to pay to First Party the sum of Five Hundred Fifty Dollars (\$550) per month on the first day of each and every month, beginning with the first day of March, 1948, and continuing to and including the first day of February, 1951, and shall pay to First Party the sum of Two Hundred Fifty Dollars (\$250) per month from the first day of March, 1951, until the first day of February, 1954. Said payments shall continue as provided in this paragraph notwithstanding the fact that the First Party remarries at any time hereafter, and should Second Party die prior to February 1, 1951, said payments shall continue until February 1, 1951, and shall be payable by the estate of Second Party as herein provided until said first day of February, 1951, and not thereafter. Should Second party die between February 2, 1951, and February 28, 1954, said payments shall cease on the date of his death. Said payments shall cease upon the death of First Party. Whether or not First Party remarries, the obligations of Second Party to First Party to make payments under this agreement or under said agreement of March 6, 1946, or otherwise, shall cease with the payment to be made on February 1, 1954, or on the date of the death of the First Party, whichever event earlier occurs. \* \* \* It is further understood and agreed that one of the important considerations moving Second Party to make payments to First Party during the fourth, fifth and sixth years hereof at the rate of Two Hundred

Fifty Dollars (\$250) per month, is the fact that the child of the parties is now remaining with Second Party. Payments for said fourth, fifth and sixth year shall cease if and when continuous custody is given to the First Party during or prior to the commencement of said third, fourth or fifth years, and First Party from and after said date waives any claim to such payments pursuant to the provisions of this paragraph. The obligation of the Second Party to make payments to the First Party pursuant to the provisions of this paragraph are in settlement of the obligations of Second Party to support First Party pursuant to the provisions of Paragraph 2 of the Property Settlement Agreement dated March 6, 1946. In consideration of the Second Party's agreement to make payments under this agreement notwithstanding the remarriage of First Party, the provisions of Paragraph 2 of the Property Settlement Agreement dated March 6, 1946, are hereby cancelled and terminated and shall have no force or effect whatsoever, it being expressly understood and agreed that the sole obligation on the part of Second Party to First Party for support, alimony and/or maintenance by reason of the prior marriage between the parties hereto shall be as set forth in this agreement which shall supersede and take the place of the provisions of said Paragraph 2 of said Property Settlement Agreement. First Party does hereby waive any claim for support, maintenance, or otherwise except as in this agreement provided and does release Second Party of any other claims, demands and causes

of action of any kind or character except as provided in this agreement. \* \* \*

Idy Hollander remarried on March 29, 1948.

Subsequent to June 12, 1946, Idy had become a resident of California. On or about May 18, 1948, an action was instituted by petitioner in the Superior Court of the State of California, in and for the County of Los Angeles, to establish the Nevada judgment of divorce as a foreign judgment. On June 30, 1948, the California court entered a decree as follows:

This cause came on to be heard before Honorable Stanley Mosk, Judge Presiding in Santa Monica Department A on the 30th day of June, 1948, I. H. Prinzmetal of Prinzmetal & Grant appearing as attorney for the plaintiff, the defendant having filed a Notice of Appearance through her attorney, Milton Wichner, and no answer having been filed by the defendant, and the default of the defendant having been duly entered and the parties hereto having filed a Stipulation consenting to the entry of this Order,

It Is Ordered, Adjudged and Decreed:

(1) That the judgment of divorce rendered by the Eighth Judicial District of the State of Nevada in and for the County of Clark be established as a foreign judgment and that the same be enforced in this action subject to modifications as herein set forth;

(2) That the agreement between the parties dated March 16, 1948, be and the same is hereby ratified, confirmed and approved and the plaintiff is ordered to make payments to the defendant pursuant to said property settlement agreement.

(3) It Is Further Ordered, Adjudged and Decreed that until the further order of the Court the Plaintiff be and he is hereby awarded the care, custody and control of Barbara Mia Hollander, the minor child of the parties hereto but with full rights of visitation by the defendant.

Done in Open Court this 30th day of June, 1948.

STANLEY MOSK,  
Judge.

On or about August 5, 1948, petitioner married Clemence Blum Hollander. Petitioner is presently a resident of Los Angeles, California, and Clemence Hollander is presently a resident of San Francisco.

During 1948 petitioner made twelve monthly payments of \$550 each to his former wife, paid \$1,990.40 to the Federal Government on account of her liability for 1947 Federal income tax and paid \$67 to the State of California on account of her liability for 1947 California income tax.<sup>1</sup> The ag-

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<sup>1</sup>The 1946 agreement provided for the withholding by petitioner of amounts necessary to pay all income taxes which might be assessed against Idy on account of the payments to be made under the agreement. The 1948 agreement contained a similar provision.

gregate amount of these payments was \$8,657.40. Petitioners claimed the full amount of the payments as an alimony deduction on their 1948 income tax return. In connection with the amount so claimed, the respondent allowed \$2,057.40 as representing amounts paid by petitioner on account of Idy's 1947 liability for Federal and California income taxes and \$1,650 as representing three monthly payments of \$550 each made to Idy during the first three months of 1948. The balance of the amount claimed by petitioners as an alimony deduction on their 1948 return was disallowed.

During 1949 petitioner made twelve monthly payments of \$550 each to Idy, paid \$1,225.44 to the Federal Government on account of her liability for 1948 Federal income tax and paid \$42 to the State of California on account of her liability for 1948 California income tax. The aggregate amount of these payments was \$7,865.44. Petitioners claimed the full amount of these payments as an alimony deduction on their 1949 return. The entire amount so claimed by petitioners on their 1949 return was disallowed by respondent.

## Opinion

Turner, Judge:

Section 23 (u) of the Internal Revenue Code of 1939<sup>2</sup> provides that payments which are includible, under Section 22 (k), in the gross income of the wife, are deductible by the husband in computing his net income. In Section 22 (k)<sup>3</sup> it is provided

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### <sup>2</sup>Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

\* \* \*

(u) Alimony, Etc., Payments—In the case of a husband described in Section 22 (k), amounts includible under Section 22 (k), in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under Section 22 (k) or Section 171, stated to be not includible in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection.

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### <sup>3</sup>Sec. 22. Gross Income.

\* \* \*

(k) Alimony, Etc., Income—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband.

that there shall be included in the gross income of the wife periodic payments received by her under a decree of divorce or a written instrument incident to the divorce and in discharge of a legal obligation which, because of marital or family relationship, is imposed upon the husband by such decree or written instrument.

Stated briefly, the facts are as follows: Petitioner and Idy Hollander were divorced in June, 1946. More than two months prior to the divorce, and in contemplation thereof, petitioner and Idy had entered into an agreement looking to the settlement of all property and support claims, one against the other. This agreement provided for alimony payments to Idy for so long as she lived or until her remarriage, or until petitioner's death, and was incorporated in the decree of divorce. The agreement specifically provided that petitioner and Idy release, acquit and forever discharge each other "from any and all claims which he or she now has or may hereafter have against or upon the other for payment of maintenance or alimony excepting as herein provided." In 1948, two years subsequent to the divorce, Idy made known to petitioner her desire to marry a man who was "relatively impecunious." "In order to enable Idy to remarry," petitioner

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This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. \* \* \*

entered into a second agreement providing for payments to her subsequent to her pending remarriage, and Idy was remarried within two weeks of the execution of this agreement.

Respondent has disallowed all payments made subsequent to Idy's remarriage, contending that the payments were not in discharge of a legal obligation arising out of a marital or family relationship, nor in discharge of an obligation imposed or incurred under a divorce decree or written instrument incident to a divorce or separation, within the meaning of Section 22 (k), and therefore are not deductible under Section 23 (u).

It is the position of petitioner, on the other hand, that "where a divorced husband is under a continuing obligation to support his former wife, imposed by a decree or agreement incident to divorce, any payments made to discharge this obligation are payments made in discharge of an obligation arising out of the marital or family relationship, even if the obligation is revised by an agreement subsequent to divorce." He cites Dorothy Briggs Smith, 16 T. C. 639, affd. 192 F. 2d 841; Newton v. Pedrick, 212 F. 2d 357, reversing 115 F. Supp. 368; and Raoul Walsh, 21 T. C. 1063. In each of those cases, as petitioner indicates in his statement with respect to the principle contained therein, there was a "continuing obligation" on the part of the husband to support his former wife. In the instant case, that is not true, and this fact distinguishes this case from those cited.

A review of the Smith case and the rationale of the decision illustrates the variance between that case and the instant one. In the Smith case, during the pendency of divorce proceedings, in 1937 an agreement was entered into for the payment of \$1,000 a year to the wife for her support and the support of the two minor children. The agreement provided that a final decision as to the support to which the wife would be entitled in her own right would be made at a later date. The divorce was thereafter granted to the wife and the 1937 agreement was made part of the final decree. In 1944, after the husband had made a motion in the divorce court for a reduction of support payments, the parties executed an agreement which terminated the provisions of the 1937 agreement and provided for the payment by the husband of \$5,000 a year to the wife for her support. In 1946 the divorce court recognized this agreement. We there held that the payment of \$5,000 by the husband in 1948, under the terms of the 1944 agreement, was received by the taxpayer in discharge of a legal obligation which, because of the marital relationship, was incurred by the husband under a written instrument incident to the final decree of divorce. A study of the facts of that case leads to the conclusion that the 1944 agreement was a revision of the 1937 agreement, which admittedly was incident to divorce and in discharge of the husband's obligation for support. A like study of the facts presented in the instant case leads to a contrary conclusion. Unlike the 1937 agreement in the Smith case, the 1946

agreement here did not leave open the final disposition of the amount of support to which petitioner's former wife would be entitled. To the contrary, the 1946 agreement between petitioner and Idy was specific and delineated "a permanent and final settlement and adjustment between themselves with regard to their assets, property and property rights and obligations for support and maintenance which each has or may have or owe to the other or to the minor child." The payments to be made under the 1946 agreement were automatically to cease upon Idy's remarriage, and it was further provided in the agreement that both parties released, acquitted, and forever discharged the other "from any and all claims which he or she now has or may hereafter have against or upon the other for payment of maintenance or alimony excepting as herein provided." Petitioner, under the 1948 agreement, thus agreed to make payments to his former wife even after her remarriage and for which there was and could be no obligation under the specific terms of the first agreement, which in turn had been "ratified, confirmed and approved" in the divorce decree subsequent thereto. Although the second agreement contained words to the effect that it was in settlement of petitioner's obligations for alimony under the first agreement, there could under the first agreement be no liability for the payments here in question. The decree of divorce and the 1946 agreement incorporated therein had specified with particularity that petitioner should have no obligation to support Idy after her remarriage. The 1948

agreement, however, is bottomed on her contemplated remarriage and to a man apparently incapable of supporting her in keeping with her tastes or desires. It thus appears, we think, that the second agreement was not incident to the divorce of petitioner and Idy, but incident to Idy's remarriage, and the payments made thereunder were not only not within the purpose or intent of the first agreement but petitioner's non-liability for such payments, to borrow from the words of the agreement, had been permanently and finally settled.

Petitioner argues that his promise to make payments to Idy after her remarriage was not without consideration, in that he obtained a reduction in the amount and duration of his alimony obligation to her and the immediate legal custody of his daughter. The contention that petitioner reduced the amount and duration of his alimony is necessarily based on the supposition that Idy would not remarry unless petitioner acquiesced in continuing the alimony payments, a supposition in respect of which there is no evidence whatever. With respect to the custody of the child, it appears from the 1948 agreement that petitioner had custody of the child through a "mutual agreement" with Idy prior to the execution of the 1948 agreement and that that agreement did no more than formalize what had already been accomplished in fact by the parties many months prior to the making of that agreement.

It is our conclusion, for the reasons stated, that the payments made subsequent to Idy's remarriage were not made in discharge of a legal obligation which, because of the marital or family relationship, was imposed upon or incurred by petitioner as incident to divorce, and are not within the contemplation of Section 22 (k), as petitioner contends. Accordingly, they are not deductible by him under Section 23 (u).

Decision will be entered for the respondent.

Served July 17, 1956.

Entered July 17, 1956.

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The Tax Court of the United States

Docket No. 51365

HANS S. HOLLANDER and CLEMENCE  
BLUM HOLLANDER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 17, 1956, it is

Ordered and Decided: That there are deficiencies in income tax for the calendar years 1948 and 1949 in the respective amounts of \$6,866.59 and \$3,947.58.

[Seal]      /s/ BOLON B. TURNER,  
                  Judge.

Served July 19, 1956.

Entered July 19, 1956.

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In the United States Court of Appeals  
for the Ninth Circuit  
T. C. Docket No. 51365

HANS S. HOLLANDER and CLEMENCE  
BLUM HOLLANDER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

#### **PETITION FOR REVIEW**

Taxpayers, the Petitioners in this cause, by Lawrence E. Irell, Louis M. Brown and Edward Sanders, counsel, hereby file their petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision of The Tax Court of the United States on July 18, 1956, 26 T.C. No. 102, Docket No. 51365, determining deficiencies in the Petitioners' federal income taxes for the taxable years 1948 and 1949 in the respective amounts of \$6,866.59 and \$3,947.58, and respectfully show:

## I.

The Petitioners are individuals, and at all times material hereto, husband and wife. Hans S. Hollander is presently a resident of Los Angeles, California, and Clemence Blum Hollander is presently a resident of San Francisco, California.

The returns for the petitioners here involved were filed with the Collector for the First District of California at San Francisco, California, so that pursuant to the provisions of Internal Revenue Code of 1954, Section 7482(b)(1), (Section 1141 (b)(1) of the Internal Revenue Code of 1939), the aforesaid decision of The Tax Court of the United States may be reviewed by the United States Court of Appeals for the Ninth Circuit.

## II.

## Nature of the Controversy

The controversy involves the proper determination of the Petitioners' liability for federal income taxes for the calendar years 1948 and 1949. Petitioners, from and after August 5, 1948, were husband and wife. Petitioner Hans S. Hollander was previously married to Idy Hollander and the case raises the issue of whether Petitioners properly deducted certain alimony payments made by Hans S. Hollander to his former wife, Idy, during 1948 and 1949.

On March 6, 1946, in contemplation of divorce, Hans and Idy Hollander entered into a Property Settlement Agreement which, among other things,

provided for certain alimony payments to be made by Hans S. Hollander to Idy Hollander until her death or remarriage and awarded Idy Hollander custody of the child of the marriage. On June 12, 1946, the Eighth Judicial District of the State of Nevada entered its decree of divorce between the parties which incorporated the aforesaid Property Settlement Agreement of March 6, 1946, as part of the decree and ordered Hans S. Hollander to comply with the terms of said Agreement.

On March 16, 1948, and while Hans S. Hollander was under an existing and continuing legal obligation to support his former wife, imposed by the 1946 decree and Agreement, Hans and Idy Hollander entered into a modification of the 1946 Property Settlement Agreement. This modification, among other things, provided for reduced payments to Idy Hollander for a definite period whether or not she remarried, and granted Hans S. Hollander legal custody of the child of the marriage. Idy Hollander remarried subsequent to March 16, 1948.

Petitioners deducted as alimony payments made pursuant to the Agreement of March 16, 1948. The Commissioner of Internal Revenue disallowed as alimony deductions all payments made under said Agreement.

### III.

The said Hans S. Hollander and Clemence Blum Hollander, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision en-

tered pursuant thereto, desire to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

#### IV.

##### Assignments of Error

The Petitioners assign as error the following acts and omissions of The Tax Court of the United States:

- (1) The finding that the payments under the Agreement of March 16, 1948, were not incident to the divorce.
- (2) The finding that the payments under the Agreement of March 16, 1948, were incident to Idy's remarriage to her new husband rather than the divorce from Hans S. Hollander.
- (3) The finding that the payments under the Agreement of March 16, 1948, were not in discharge of a continuing obligation of support to a former wife arising out of the marital or family relationship.
- (4) The failure to recognize the fact that on March 16, 1948, the date of the modifying agreement, Hans S. Hollander was under an existing and continuing legal obligation to support his former wife.
- (5) The failure to take into account the fact that Idy Hollander had not remarried on March 16, 1948, the date of the modifying agreement, so that Hans S. Hollander's obligation to support his former wife was in full force and effect.

(6) The failure to give recognition to the March 16, 1948, Agreement as continuing the support obligation of Hans S. Hollander.

(7) The failure to find that the payments made by Hans S. Hollander pursuant to the Agreement of March 16, 1948, were in discharge of a legal obligation imposed upon him under a decree of divorce and under a written instrument incident to the divorce.

(8) The failure to find that the payments made by Hans S. Hollander to his former wife during 1948 and 1949 were in discharge of a legal obligation arising out of the marital or family relationship.

(9) Disregarding the order of the Superior Court in and for the County of Los Angeles, State of California.

(10) The finding of deficiency in income taxes for the calendar years 1948 and 1949 in the respective amounts of \$6,866.59 and \$3,947.58.

LAWRENCE E. IRELL,  
LOUIS M. BROWN, and  
EDWARD SANDERS,  
Counsel for Petitioners.

By /s/ LOUIS M. BROWN,

By /s/ EDWARD SANDERS.

Duly verified.

Received and filed October 5, 1956, T.C.U.S.

In the Tax Court of the United States

Docket No. 51365

HANS S. HOLLANDER and CLEMENCE BLUM  
HOLLANDER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

TRANSCRIPT OF PROCEEDINGS

Monday, April 26, 1955

The above-entitled matter came on for hearing, pursuant to notice to the parties, at 2:00 o'clock p.m.

Before: Honorable Bolon B. Turner, J., Presiding.

Appearances:

EDWARD SANDERS, ESQ.,

For the Petitioners.

R. W. JANES, ESQ.,

(Hon. Daniel A. Taylor, Chief Counsel, Internal Revenue Service),

For the Respondent.

The Clerk: Docket 51365, Hans S. Hollander and Clemence Blum Hollander.

Will you state your appearances, please, for the benefit of the record?

Mr. Sanders: Edward Sanders for Petitioner.

The Clerk: 6399 Wilshire Boulevard, Los Angeles 48.

Mr. R. W. Janes for the Respondent.

The Court: All right. What is the case about?

Mr. Sanders: Your Honor, the facts in this case have been fully stipulated to by counsel, and I present to the Court at this time the stipulation, together with the exhibits attached thereto.

The Court: The stipulation will be received and made a part of the record.

Mr. Sanders: Your Honor, this case involves income taxes of Petitioners for the calendar years 1948 and 1949, and involves a deduction for alimony claimed by the taxpayers on their joint returns for these years.

Petitioner Hans S. Hollander was married in 1937 to Idy Hollander. In March of 1946, an agreement was entered into between Hans and Idy, his first wife, in contemplation of divorce, and a copy of that agreement is incorporated in the stipulation of facts.

In June of 1946, Idy Hollander established [3\*] residence in Nevada and obtained a divorce, an uncontested divorce from Hans, and under the decree of the Nevada court the terms of the property settlement agreement of March of 1946, were incorporated into the decree, and the parties were ordered to comply with that decree.

In March of 1948, a second agreement was entered into between Idy Hollander and Hans Hol-

lander, because of various circumstances which arose between 1946 and 1948, which facts and circumstances are set out in the stipulation.

This 1948 agreement modified and revised the 1946 agreement. Later in '48, June of '48, an action was instituted by Hans Hollander in the Los Angeles Superior Court to establish the Nevada decree of 1946 as a foreign judgment, and also to incorporate the later agreement, the 1948 agreement, into the Nevada decree.

On June 30, 1948, a decree of the California court was entered, adopting the Nevada decree as a foreign judgment, modifying it to the extent of the 1948 agreement between Idy Hollander and Hans Hollander, and ordering the parties to comply with the terms of the 1948 agreement. A copy of the decree of the California court is incorporated in the stipulation. Also, a copy of the 1948 agreement is incorporated into the stipulation.

During the calendar years 1948 and 1949 Hans Hollander made certain payments to his first wife, Idy Hollander, under [4] the provisions of the 1948 agreement. It is these payments which were deducted by Petitioners as an alimony payment which the Commissioner has disallowed.

The issue which has been discussed by the taxpayer and counsel for the Respondent has been that the Government has claimed that these payments, made under the 1948 agreement, were not made under an agreement which was incident to divorce. It is the position of the Petitioner, as will be argued on briefs, that the second agreement was

clearly incident to the divorce, and that particularly in view of the latest cases of the Tax Court, with particular reference to Raoul Walsh in 21 Tax Court at page 1063, that the agreements—the payments made under the agreement of 1948 were clearly made under an agreement which was incident to divorce and therefore deductible by Petitioners.

The Court: You take the position this is the same situation as existed and comparable to that in the Walsh case?

Mr. Sanders: We take the position that the situation in the Walsh case was even beyond the situation in this case. In the Walsh case, the parties annulled, cancelled, and abrogated an earlier agreement. I believe an agreement which was some 14 years before the modifying agreement. And as you recall, the Tax Court held in this latest Walsh case that the payments under the second agreement were incident to the divorce. In our case, in the Hollander case, the second agreement, some 18 or 19 months after the first agreement, did not cancel or abrogate the [5] first agreement. It merely modified and revised the agreement, and recited in it that all of the terms and provisions of the initial agreement were still alive and still in effect, except as changed, and the parties then went one step further and had this second agreement incorporated in a decree of the California court.

We believe that the philosophy and the spirit of the Walsh case extends to our fact situation at this time, but that our fact situation doesn't even go as far as the Court went in the Walsh case.

The Court: Do I understand you to mean by that that you think that the facts in this case are stronger for the taxpayer than were the facts in the Walsh case?

Mr. Sanders: Yes, your Honor.

The Court: All right.

Mr. Janes: At this time, Respondent would offer the joint returns of Hans S. and Clemence Blum Hollander for the year 1948. I believe it would be Exhibit D.

The Clerk: Exhibit D for the Respondent.

The Court: Very well, it will be received and marked in evidence.

(The document above referred to was marked as Respondent's Exhibit D for identification and was received in evidence.) [6]

Mr. Janes: The joint return for 1949.

The Court: That will be received and marked as Exhibit E in evidence.

(The document above referred to was marked Respondent's Exhibit E for identification and was received in evidence.)

Mr. Janes: These are photostatic copies, your Honor.

The Court: Very well.

Mr. Janes: Photostatic copy of decree of divorce, Idy Hollander versus Hans S. Hollander, State of Nevada.

The Court: Dated when?

Mr. Janes: June 12, 1946.

The Court: Exhibit F in evidence.

(The document above referred to was marked as Respondent's Exhibit F for identification and was received in evidence.)

Mr. Janes: If it please the Court, this case involves no factual issues. I believe it will be easier to summarize the issue in that there are about possibly 1,200 cases in this area, and I would like to point out that counsel for the taxpayer feels that the Walsh case is stronger for the taxpayer—or, rather, that his case is stronger for the taxpayer than the Walsh case. The area of strength, according to the opening statement of [7] Petitioners' counsel, is that in this case, the Hollander taxpayer had the second agreement incorporated in a decree of the State of California. I believe the holdings in this Court and in other courts point out that such a fact is immaterial to this issue.

The issue in this case is a legal one, and it is simply whether the payments made, which are in issue as deductions, are voluntary or under an obligation. The obligation has to arise in such a way as to the incident to a decree or the marital or family relationship. In this case, the first decree involved and incorporated therein the first property settlement between the parties. This agreement called for alimony payments in—

The Court: Which agreement are you talking about?

Mr. Janes: The first agreement. Called for

alimony payments to continue until the death or remarriage of Idy. The second agreement extended alimony payments to Idy for a period of years, regardless of remarriage. There is no obligation on the part of one spouse to make support payments to the other upon remarriage. That is to say, there is no obligation in law, morals, or the State of California for a husband to make support payments to a former wife following her remarriage. These payments, then, that are here in issue were voluntary payments. They were incorporated in no decree except the immaterial decree of the State of California. They arose—— [8]

The Court: Are you attributing to the Court in California the entering of an immaterial decree, is that what you are doing?

Mr. Janes: Well, it is our position, your Honor, in our brief I believe we can substantiate it, that if an agreement is not incident to a decree, it makes no difference if the parties go from state to state incorporating agreements that are not incident to the marital obligation; they could have a hundred decrees in 48 different states, and it would not change the law. In other words, the state law on obligation is immaterial to the tax law of obligations, which we must take from 22(k) or 23(u).

The Court: But you have to have that bottomed on state law, don't you?

Mr. Janes: It is bottomed, sir.

The Court: Because you have to have a marriage and a divorce before you can get to (k), don't you?

Mr. Janes: That is right, your Honor. We look

to 22(k) in which Congress permits deductions in the nature of alimony which are made for obligations arising from the marital relationship. Now, on the divorce obtained in Nevada, and incorporated in that divorce, was the first property agreement. This property—

The Court: That was true of the Walsh case, wasn't it?

Mr. Janes: Yes, sir, that was. However, in the Walsh [9] case, I would like to quote from page 10 of 21 T.C. No. 120. I don't know the page number in the published volume. "The 1941 agreement,"—I am quoting—"though subsequent to the divorce, clearly came about as a direct revision and cancellation of the 1927 and 1934 agreements. The nature, origin and purpose of Petitioner's obligations under the 1941 agreement were substantially similar to the 1927 agreement, the primary change being a reduction of payments."

I would like to rephrase that in terms of our own factual situation. We have in this case two agreements. The Commissioner—

The Court: We had in the Walsh two agreements.

Mr. Janes: In our instant case we have two agreements. In the Walsh case, yes, sir, we had two agreements. The Walsh case permitted deductions paid, permitted deductions for amounts paid under the second agreement, and the reason for such permission—and I quote again—is, "\* \* \* the nature, origin and purpose of Petitioner's obligations,"

under the second agreement were substantially similar to those under the first agreement.

Now, factually, it is the Respondent's position here that the nature of the obligation calling for the payments in this instant case is an entirely different obligation than which called for payments under the first decree, for this reason:—

The Court: In what way? [10]

Mr. Janes: For this reason, sir: That the first payments under the first decree, first agreement—excuse me—the payments were to cease upon re-marriage, which is a natural and proper consideration when two parties are about to break the bonds of matrimony sit down and arrive at an economic balance for the mutual obligations of each. At that time, the mutual obligations are in effect laid out on the table and assessed dollar-wise, and all obligations thereafter are dissolved. That is to say, from thence forward, those payments made under that decree which incorporates the agreement are the residual results of changing matrimonial bonds, economic bonds.

In this instance, the first agreement called for payments to the former wife, to cease upon re-marriage. In this case the facts as stipulated show that subsequent to the divorce, Idy Hollander made known to her former husband that she wished to remarry. She made known to the taxpayer that the man to whom she wished to marry was relatively impecunious and, we can infer, was unable to support her adequately in her terms. The separation in this case was not contested by this taxpayer

here. We may then assume that within the bounds of public policy it was an amicable divorce. There was no bitterness or ill feeling between the parties. Mr. Hollander, as can be inferred from the returns in evidence, was a man of means and substance. He did not desire to stand in the way economic-wise of his former wife's remarriage. Apparently, the parties felt [11] that six years of alimony payments, alimony in quotes, would help the new marriage get off to a good start. In other words——

The Court: Is this just to run for six years?

Mr. Janes: Yes, sir. In other words, this taxpayer might well be praised for his generosity and tolerance to a former wife, but unfortunately we are struck with the wordage of 22(k).

The Court: And what is that word?

Mr. Janes: Perhaps I may quote from the House of Representatives' report——

The Court: Well, let's get the statute first.

Mr. Janes: This is not a full quotation, your Honor. I have a few dots here, indicating some words are omitted, but I believe it will suffice.  
“22(k) In the case of the wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the periodic payments, whether or not made at regular intervals, received subsequent to such decree in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree, or under a written instrument incident to such divorce or separation, shall be includable in the gross income of such

wife." Under the Code, 23(u) is made dependent upon the 22(k) wordage.

Now, the 77th Congress, Ways and Means Committee Report, states—— [12]

The Court: Is that the one that first passed the provison?

Mr. Janes: Yes, sir. This quotation I am reading is taken from Merton's Volume 5, Section 31A.2, page 554.

The Court: I thought you were reading from the report.

Mr. Janes: I wish, your Honor, to show the source from which I picked up the quotation from the report, in case there is some variance.

The Court: All right.

Mr. Janes: "This section applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation to support, which is made specific by the instrument or decree."

There is no general obligation to support following the remarriage of the former spouse.

The Court: Are you quoting or making a statement?

Mr. Janes: End of quote, your Honor. I am back on my own now, and the Respondent's position on briefs. There are many cases which point out that a husband has no obligation to support a wife after her remarriage. No such obligation is imposed by statute, and there appears to be no ground for suggesting there is any moral obligation to do so, nor that there is any such obligation

arising from general law. Where, then, it is the Respondent's position, what obligation does taxpayer [13] have, is taxpayer discharging when he made the payments here in issue?

The Court: Well, I think before I make some comment about what I want you to cover on the briefs, I want to hear from the Petitioners' counsel on this matter.

Mr. Sanders: Your Honor, the Respondent has emphasized in his opening statement the fact that certain of these payments, or the payments that are in controversy, continued after the remarriage of Mr. Hollander's first wife, and that there was no obligation to support the wife imposed on Mr. Hollander under law or under the original agreement.

First, the Petitioner would like to respectfully call to the Court's attention the case of Brown versus the United States, before the United States District Court for the Northern District of California. It involved a California husband and wife situation, involved the interpretation of California law, and payments which continued after remarriage. The Court pointed out in that case that there was no requirement under 22(k) that the payments be characterized as alimony under State law, and that if the payments were in discharge of an obligation which arose out of the marital relationship and were in the nature of alimony or even separate maintenance payments, that these payments could qualify under 22(k). In addition—

The Court: Where would that fit this case?

Mr. Sanders: Well, in this case, these payments

which [14] were made after remarriage—it is Petitioners' point—that the fact that California law may not impose any obligation to make payments to the wife is really immaterial in connection with Section 22(k), as pointed out under the Brown case.

Furthermore, it is the Petitioners' position that the original obligations imposed under the Nevada decree and the first agreement were clearly—and stipulated—incident to the divorce, that these obligations assumed by the Petitioners in the second agreement arose out of the first agreement and retained the same character—

The Court: What do you mean "arose out of"? If they would have come to an end on remarriage, and these payments were after remarriage, and this agreement to pay after remarriage—how could you say that they arose out of it or were any part of it?

Mr. Sanders: The obligations assumed by the taxpayer under the second agreement were merely a reshuffling of his obligations under the first agreement. They were a revision of the schedule of payments. They extended the payments beyond the possible remarriage of the wife. The agreement changed the custody provisions of the child. As the Court in the Second Circuit said in Newton versus Pedrick, when they were faced with somewhat of a similar situation in connection with payments made under a second agreement, the Court in that case stated that the [15] second agreement merely reshuffled the obligations and recast the obligations of the first agreement.

The Court: What do you mean "reshuffled"?

That is a term that is a little bit indefinite to me in relation to this sort of thing. I don't exactly follow what is meant, or the significance of the word. I think that a more apt term could be had if it is to impart any meaning here to me; I think it is a bad choosing. It is a bad choosing of a term, as far as I am concerned.

Mr. Sanders: The position of the Petitioner can be summed up in this way, your Honor: I believe that, clearly, the original obligation imposed upon Hollander under the 1946 Nevada decree and the earlier agreement was incident to the divorce; that the changes which were made by the 1948 agreement and the California decree, were merely changing the terms of payment, as far as their duration was concerned, and merely changing the custody of the child; and that as the first agreement—

The Court: What does the custody of the child have to do with this payment that is deductible or not deductible which is to go to the wife as alimony or for her support and maintenance? Because the statute very definitely cuts a line there, and there is no deduction provision allowed in case of support and maintenance of the child.

Mr. Sanders: I understand that, your [16] Honor.

The Court: So I just don't understand how the fact that there was something in this later agreement to do with the child, how that would have anything to do with the question here.

Mr. Sanders: Well, actually, I mention it only

for background material, and from Petitioners' point of view the fact of the wife's remarriage and the economic situation of her husband, and the fact that Mr. Hollander did get custody of the child, are immaterial. It is our position that, if the first agreement was incident to the divorce, that any modification or revision of that first agreement and decree would also be incident to the divorce, to the divorce and the status and decree of divorce.

The Court: It would be much easier to follow you on that argument, all right, if the payments weren't to extend after remarriage, and deliberately so.

Mr. Sanders: Well, your Honor——

The Court: I never heard of an alimony grant by any court which obligated a former husband to take care of a former wife after she remarried someone else who assumed that obligation.

Mr. Sanders: If the first agreement had so provided and the parties had agreed on these same terms in the first agreement, and that agreement had been adopted and incorporated by the Nevada court, certainly under those circumstances there would be no argument that the payments were not incident to the [17] divorce.

The Court: I hear you say that. What authority do you have for that, insofar as the payments after the remarriage?

Mr. Sanders: The Brown case, your Honor.

The Court: Was that the Brown case——

Mr. Sanders: That was concerned with those facts. In that case, the original agreement provided

for payments after remarriage and the Commissioner took the position in that case that, because the payments continued after remarriage, that they were not deductible under Section 22(k) and the Circuit Court rejected that argument. Also, in that connection, I point out to the Court I.T. 41081952-CB, 113, where the Commissioner himself was concerned with the question of deductibility of payments after remarriage, and in that, took the position that payments after remarriage were deductible under this section. So it has been the Petitioners' position that if the original agreement had contained the same provisions as the second agreement, that then there certainly would have been no argument.

The Court: There would be this difference, that this agreement—according to my understanding of the statements here—of course, I will look at the facts when I come to the matter of disposing of the case—that, as I followed it, this agreement, insofar as these payments are concerned, was not looking to divorce at all. It was looking at the remarriage [18] of the first wife.

Mr. Sanders: Your Honor, it is true that the facts of the remarriage of the wife were part of the motivating factors which went into the second agreement.

The Court: As far as the wife is concerned, what other factor did it have?

Mr. Sanders: I don't know, your Honor.

The Court: Laying aside the questions about the child, which could not determine this anyhow.

Mr. Sanders: I don't know, your Honor, because I have never spoken to Idy Hollander.

The Court: You would have to find them in the transaction.

Mr. Sanders: That is right, your Honor. And the only other factor or motivating factor would be the custody of the child, as far as I can see from the agreements. But it is petitioners' viewpoint and position that, if the first agreement was incident to the divorce, that the revision and modification of that agreement was also incident to divorce.

The Court: Well, I could see where that would be true if it had to do with matters that normally come within the range of the divorce, namely, the satisfaction of the obligation of the husband to care for a wife. It is not so clear to follow beyond, even though I hear you say so, and even though you tell me that the United States District Court [19] has held that it was, if that was, if that was a part of the agreement at the time of the divorce. Of course, there is this difference between that and this, and that is that that agreement was looking to the divorce, and this one, so far as I see now—I haven't heard anything which would tell me that this one was.

Mr. Sanders: Well, this one, as far as the matter of time, was clearly subsequent to the time.

The Court: Very well. Now, of course, this situation arose out of one that was brought about by the opinion of the Supreme Court in *Douglas versus Wilkins*, dealing in the principle that a person was not entitled to a deduction for paying his own obli-

gations, and an obligation incident to his marriage relationship.

Similarly, I can see where we wouldn't have had a different situation prior to 23(u) and 22(k) in this sort of thing, because it would probably have been regarded as being without consideration if it was looking to the remarriage and the paying of something that the man was not obligated to do in the first place.

Now, however, we do have a question of interpreting and applying the statute, and sometimes when Congress makes that change it goes outside the scope of those principles that have theretofore been applicable and which brought about the legislation itself. I may say that the Walsh case, and insofar as its [20] applicability here is concerned—and if it were, and as I understood from counsel for the Petitioner, it was his position that the Walsh case was a weaker case for the taxpayer, then I could pose this question to the Respondent. And that is that indicated by the history of the Walsh case. There, in an earlier year, as I recall, the Tax Court held that the prior—the second agreement did not fall within the statute, and that the first wife was in the clear, and that the items were not taxable to her, and therefore they were not deductible by the husband, and we were affirmed in the Court of Appeals in the District of Columbia.

Then we come along with the same case where the husband, the former husband, is seeking a deduction, and at the same time a case for certain years tried in this Court, a case for a different year

is tried in the District Court here, where the husband is seeking a refund, claiming that he was entitled to a deduction he didn't take. And while the matter was pending here, I mean pending before the Tax Court, the decision came out that the husband was entitled to the deduction within the statute, and then of course, not having decided the case, we looked with interest to see what the Respondent was going to do, because there was certainly a direct conflict in principle between the decision of the District Court and the decision of the Tax Court in the former wife's case, and the decision of the Court of Appeals affirming it. But somebody in the Government, whether [21] it was the Internal Revenue Service or the Department of Justice, sat on their hands and let the conflict rest. So there I assume that on the case law, neither Walsh nor the former wife was paying any tax on that income. Now, just why the Revenue Service or the Department of Justice would do that, I don't know. And yet we had no word in the Tax Court to the effect that they were not still pressing the matter for us, when, as a matter of fact, if we decided it in favor of the Government—and under our prior decision it would come right back to the Ninth Circuit, the same Court of Appeals to which the Government would have to appeal in the District Court case—well, as I say, I know that sometimes the Revenue Service does not have the final say. There is difficulty in clarifying and getting a settled interpretation of the law, when Justice refuses for some reason best

known to them to try to proceed to clear up things at the time.

Now, in this case, after I get some further facts, it appears that there is a difference between it and the Walsh case. Now, first—and this I say to Respondent's counsel and to Petitioners' counsel, both, but more particularly Respondent's counsel because I want it dealt within brief—to the extent that 22(k) and 23(u) are dealing with alimony, then I could follow certain reasoning, because I have never heard of an obligation where the obligation is imposed by a court to pay alimony was carried over and extended beyond the remarriage of [22] the spouse that was being supported. I don't know if there is any such obligation in the law which calls on a prior husband to support a former wife after she is remarried. I never heard of it. And I never heard of a court holding jurisdiction in an alimony payment to require it. If I am wrong in the law, in that analysis, I will expect counsel to clear it up for me.

The second point is, which is directed to the Petitioners' counsel more particularly, because it seems to me that that is where he must find the answer to the case in his favor, if it is to be found—and assuming that I am right on my idea of alimony, is to show me wherein, under the statute, Congress provided that a payment made under an agreement of this sort, looking to the remarriage of the former wife and not to divorce, is covered by 22(k) so as to be taxable to the former wife and deductible—

under 23(u) so as to be deductible by the former husband.

Now, I can say this, but it has little to do with the question of the language of the statute of the Congressional intent, unless Congress somewhere brought it in, but I think that in fairness to the former husband, if he is going to support the former wife after she has remarried, and the other husband has assumed the obligation to support her until death parts them, he ought to be willing to pay the tax on it. But that is not a question that we have here. We have a question of law and a question of determining what Congress intended. [23]

So I am going to expect you gentlemen, as good lawyers, to have all of that spelled out very simply and decisively for me in briefs. You will be allowed 90 days for briefs and 30 days for reply.

The case will stand submitted upon the filing of briefs.

**Mr. Janes:** Will they be simultaneous briefs?

**The Court:** Yes, and I want good reply briefs.

**The Clerk:** Ninety days for the original briefs, and 30 days.

**The Court:** If I get a good reply brief, I often find it of more help than I do the original briefs.

(Whereupon, at 2:55 o'clock p.m., the hearing in the above-entitled matter was closed.)

Filed May 16, 1955, T.C.U.S. [24]

[Title of Tax Court and Cause.]

## DOCKET ENTRIES

1953

Nov. 30—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 1—Copy of petition served on General Counsel.

Nov. 30—Request for Circuit hearing in Los Angeles, Calif., filed by taxpayer. 12/2/53—Granted.

1954

Jan. 26—Answer filed by General Counsel.

Jan. 28—Copy of answer served on taxpayer—Los Angeles, Calif.

1955

Feb. 8—Hearing set April 25, 1955—Los Angeles, Calif.

Apr. 26—Hearing had before Judge Turner on the merits, Appearance of Edward Sanders; and Stipulation of Facts filed at hearing, Appearance of Louis M. Brown, filed at hearing. Briefs due 90 days from April 26, 1955; Replies due 120 days from April 26, 1955.

May 16—Transcript of Hearing 4/26/55 filed.

July 8—Motion for extension of time to 8/25/55 to file brief, filed by taxpayer. 7/8/55—Granted.

July 19—Motion for extension of time to 8/25/55 to file brief, filed by General Counsel. 7/20/55—Granted.

1955

Aug. 23—Brief filed by taxpayer.

Aug. 25—Brief filed by General Counsel.

Sept. 19—Motion for extension to October 25, 1955,  
to file reply brief filed by taxpayer.  
9/20/55—Granted.

Oct. 24—Reply Brief filed by taxpayer. Copy  
served.

Oct. 24—Reply Brief filed by General Counsel.

1956

July 17—Findings of Fact and Opinion filed. Judge  
Turner, Decision will be entered for the  
Respondent. Served 7/17/56.

July 18—Decision entered, Judge Turner, Div. 8.  
Served 7/19/56.

Oct. 5—Petition for Review by U. S. Court of  
Appeals for the Ninth Circuit with assign-  
ments of error filed by petitioner.

Oct. 5—Notice of filing Petition for Review with  
proof of service thereon, filed.

Oct. 12—Designation of contents of record on re-  
view with proof of service thereon, filed.

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[Title of Tax Court and Cause.]

### CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of  
the United States, do hereby certify that the fore-  
going documents, 1 to 11, inclusive, constitute and  
are all of the original papers on file in my office as  
called for by the "Designation of Contents of Rec-

ord on Review," including exhibits 1-A thru 3-C, attached to the Stipulation of Facts and Respondent's exhibits D, E and F, admitted in evidence, in the case before the Tax Court of the United States docketed at the above number and in which the petitioners in the Tax Court have initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 24th day of October, 1956.

[Seal]      /s/ HOWARD P. LOCKE,  
Clerk, Tax Court of the  
United States.

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[Endorsed]: No. 15357. United States Court of Appeals for the Ninth Circuit. Hans S. Hollander and Clemence Blum Hollander, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: November 2, 1956.

Docketed: November 9, 1956.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for  
the Ninth Circuit.

In the United States Court of Appeals  
for the Ninth Circuit

No. 15357

HANS S. HOLLANDER and CLEMENCE BLUM  
HOLLANDER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### STATEMENT OF POINTS

Comes now Hans S. Hollander and Clemence Blum Hollander, petitioners on review in the above-entitled cause, by their attorneys, Lawrence E. Trell, Louis M. Brown and Edward Sanders, and hereby state that they intend to rely upon the following points in this proceeding. The petitioners assign as error the following acts and omissions of The Tax Court of the United States:

- (1) The finding that the payments under the Agreement of March 16, 1948, were not incident to the divorce is contrary to the evidence.
- (2) The finding that the payments under the Agreement of March 16, 1948, were incident to Idy's remarriage to her new husband rather than the divorce from Hans S. Hollander is contrary to the evidence.
- (3) The finding that the payments under the Agreement of March 16, 1948, were not in discharge

of a continuing obligation of support to a former wife arising out of the marital or family relationship.

(4) The failure to recognize the fact that on March 16, 1948, the date of the modifying agreement, Hans S. Hollander was under an existing and continuing legal obligation to support his former wife.

(5) The failure to take into account the fact that Idy Hollander had not remarried on March 16, 1948, the date of the modifying agreement, so that Hans S. Hollander's obligation to support his former wife was in full force and effect.

(6) The failure to give recognition to the March 16, 1948 Agreement, as continuing the support obligation of Hans S. Hollander.

(7) The failure to find that the payments made by Hans S. Hollander pursuant to the Agreement of March 16, 1948, were in discharge of a legal obligation imposed upon him under a decree of divorce and under a written instrument incident to the divorce.

(8) The failure to find that the payments made by Hans S. Hollander to his former wife during 1948 and 1949 were in discharge of a legal obligation arising out of the marital or family relationship.

(9) Disregarding the order of the Superior Court in and for the County of Los Angeles, State of California.

(10) The finding of deficiency in income taxes for the calendar years 1948 and 1949 in the respective amounts of \$6,866.59 and \$3,947.58.

LAWRENCE E. IRELL,  
LOUIS M. BROWN and  
EDWARD SANDERS,  
Counsel for Petitioners;

By /s/ LOUIS M. BROWN;

By /s/ EDWARD SANDERS.

[Endorsed]: Filed November 9, 1956, U.S.C.A.







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No. 15357

IN THE

# United States Court of Appeals FOR THE NINTH CIRCUIT

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HANS S. HOLLANDER and CLEMENCE BLUM HOLLANDER,  
*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

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## PETITIONERS' OPENING BRIEF.

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### Pleadings and Jurisdictional Facts.

On November 30, 1953, the above named petitioners filed their Petition in the Tax Court of the United States for redetermination of the deficiencies in income tax for the taxable years 1948 and 1949 in the respective amounts of \$6,866.59 and \$3,947.58. Petitioners alleged that the payments of petitioner Hans S. Hollander to his former wife, Idy, were deductible under Section 23(u) of the Internal Revenue Code of 1939 and that the Commissioner of Internal Revenue erred in denying such deduction. [R. 3-13.]

An Answer was filed in the Tax Court on January 26, 1954. [R. 13-14.]

A Stipulation of Facts was filed in the Tax Court on April 26, 1955 [R. 14-43], and on which day hearing was held before the Tax Court sitting in Los Angeles, California. [R. 69-89.]

Following the promulgation of Findings of Fact and Opinion [R. 43-63], the Tax Court entered its decision on July 18, 1956, that there are deficiencies of \$6,866.59 and \$3,947.58 for the taxable years 1948 and 1949, respectively. [R. 63-64.]

Petition to review by this Court of said decision was filed October 5, 1956. [R. 64-68]. Said Petition was docketed on November 9, 1956 [R. 92], and the Statement of Points [R. 93-95] and Designation of Contents of Record on Review were filed on October 12, 1956. [R. 91.]

This Court has jurisdiction pursuant to Section 7482(b)(1) of the Internal Revenue Code of 1954 (Section 1141(b)(1) of the Internal Revenue Code of 1939).

### **Statement of the Case.**

This controversy involves the proper determination of the petitioners' liability for federal income taxes for the calendar years 1948 and 1949. Petitioners, from and after August 5, 1948, were husband and wife and filed joint federal income tax returns for the calendar years 1948 and 1949. [R. 15.] Petitioner Hans S. Hollander was previously married to Idy Hollander [R. 15], and the case raises the issue of whether alimony payments made by Hans S. to Idy Hollander were properly deducted by petitioners on their joint federal income tax returns for the calendar years 1948 and 1949. The statutory provisions on which this controversy hinges are Sections 22(k)

and 23(u) of the Internal Revenue Code of 1939 (set out in Appx. A), which Sections state that periodic alimony payments are includable in a divorced wife's income and deductible by a divorced husband when such payments are made to the former wife in discharge of a legal obligation imposed upon or incurred by the husband because of the marital or family relationship and are made pursuant to a decree or a written instrument incident to such divorce or separation.

Hans S. Hollander was married to Idy Hollander on September 30, 1937. [R. 15.] On March 6, 1946, in contemplation of divorce, Hans and Idy Hollander entered into a property settlement agreement. [R. 15.] Under the terms of this agreement Hans S. Hollander agreed to pay Idy Hollander during her lifetime a maximum of \$10,000.00 annually for her support and maintenance until her death or remarriage, agreed to name Idy as beneficiary of certain life insurance policies, and agreed to award Idy sole legal custody of the only child of the marriage. [R. 19-31.] Shortly thereafter, Idy Hollander, then a resident of the State of Nevada, instituted divorce proceedings against Hans S. Hollander; and on June 12, 1946, the Nevada Court entered its Decree of Divorce, and incorporated the aforesaid property settlement agreement of March 6, 1946, as part of its decree and ordered Hans S. Hollander to comply with the terms of said agreement. [R. 16.] The Commissioner of Internal Revenue does not question that the payments under this original decree and agreement were incident to the divorce and properly deductible by Hans S. Hollander under Section 23(u) of the Internal Revenue Code of 1939. [R. 18-19.]

On March 16, 1948, at a time when the obligations under the original 1946 property settlement agreement were in full force and effect, Hans S. and Idy Hollander entered into an agreement modifying these obligations. [R. 16.] This modifying agreement was bargained for and supported by legal consideration in the form of mutual promises. The negotiations leading to the modifying agreement were precipitated by Idy Hollander's desire to marry a "relatively impecunious individual." [R. 16-17.] In order to "enable" herself to remarry, Idy agreed to the following legal detriments: (a) reduction in the amount of payment to be given to her annually; (b) termination of all payments after a short specified period of years rather than a continuation of payments for an indefinite period, potentially measured by her natural life; (c) substitution of the child for Idy as beneficiary of the insurance policies; and (d) granting to Hans S. Hollander sole legal custody of the child. In return for these legal benefits, Hans S. Hollander agreed to pay the reduced annual amount to Idy for a specified period of years, whether or not she remarried. [R. 31-41.] This agreement of March 16, 1948, was subsequently incorporated into a decree of the Superior Court of the State of California, which ordered Hans S. Hollander to comply with the terms of the agreement of March 16, 1948. [R. 17, 42-43.] Idy Hollander remarried 13 days after the execution of the modifying agreement. [R. 17.]

The Commissioner of Internal Revenue denied deduction of payments made by Hans S. Hollander under this modifying agreement following Idy's remarriage, and the Tax Court sustained the Commissioner on the grounds

that the first property settlement agreement was a "final" settlement and not subject to modification [R. 61], and because the 1948 agreement was incident to Idy's remarriage rather than incident to the divorce of Hans S. and Idy Hollander. [R. 62.]

The Tax Court's opinion is based upon a pre-occupation with matters which have no relevance to the issues raised by the facts and the applicable rules of law. The two ultimate facts in this case are: one, that the 1948 modifying agreement and decree were incident to the divorce of Hans S. and Idy Hollander because they revised the 1946 agreement and decree which were incident to the divorce; and, two, that the payments made under the 1948 agreement and decree, being in discharge of Hans S. Hollander's continuing support obligation imposed by the 1946 agreement and decree, were payments in discharge of an obligation arising out of the marital or family relationship.

Despite the Tax Court's finding that the 1946 agreement and decree were unalterable because "final" in language, such agreement and decree were at all times subject to valid modification by the mutual consent and agreement of the parties. Further, Idy Hollander's remarriage took place 13 days *after* the execution of the 1948 agreement and, consequently, was both without effect on Hans S. Hollander's continuing alimony obligation and irrelevant to this controversy. On March 16, 1948, at the time when this modifying agreement was entered, Idy Hollander had not remarried, and conceivably, might never have remarried. [R. 17.] Further, at the time when this modifying agreement was entered Hans S. Hollander was under a binding legal obligation to support his former

wife, Idy, which obligation could only be altered by Idy Hollander's death, or by Idy Hollander's remarrying, or by Idy Hollander's agreeing to an alteration. The first two contingencies not having taken place on March 16, 1948, Hans S. Hollander's ability to modify his alimony obligation and obtain the legal custody of his child was dependent upon securing the consent of Idy Hollander. This he did by entering into an agreement that was bargained for and supported by traditional legal consideration. Hans S. Hollander might have refused to agree to modify the original settlement terms and might have waited to see if Idy would end his obligation by remarrying in any event. But Hans S. Hollander had no assurance that Idy would ever remarry. The Commissioner of Internal Revenue has never argued otherwise; and, indeed, the inference to be drawn from the stipulated fact that the modifying agreement "enabled" Idy Hollander to remarry [R. 17] is that Idy would not have been able to remarry without such modification. At any rate, the record is barren of any evidence which would justify the Commissioner of Internal Revenue or the Tax Court as treating the modification agreement in the same manner as if it had been executed after Idy Hollander had remarried and had rejuvenated an obligation that had been discontinued by such remarriage, which is the position upon which the Tax Court's decision seems to be based.

To conclude, at all times pertinent to this controversy, Hans S. Hollander has made alimony payments pursuant to binding contractual obligations and judicial decrees ordering such payments, which payments were properly included by Idy Hollander in her gross income [R. 18] and deductible by Hans S. Hollander.

### Specification of Errors.

The petitioners assign as error the following acts and omissions of the Tax Court of the United States:

(1) The finding that the payments under the agreement of March 16, 1948, were not incident to the divorce of Hans S. and Idy Hollander.

(2) The finding that the payments under the agreement of March 16, 1948, were incident to Idy's remarriage to her new husband rather than the divorce from Hans S. Hollander.

(3) The finding that the payments under the agreement of March 16, 1948, were not in discharge of a continuing obligation of support to a former wife arising out of the marital or family relationship.

(4) The failure to recognize the fact that on March 16, 1948, the date of the modifying agreement, Hans S. Hollander was under an existing and continuing legal obligation to support his former wife.

(5) The failure to take into account the fact that Idy Hollander had not remarried on March 16, 1948, the date of the modifying agreement, so that Hans S. Hollander's obligation to support his former wife was in full force and effect.

(6) The failure to give recognition to the March 16, 1948 agreement, as continuing the support obligation of Hans S. Hollander.

(7) The failure to find that the payments made by Hans S. Hollander pursuant to the agreement of March 16, 1948, were in discharge of a legal obligation imposed upon him under a decree of divorce and under a written instrument incident to the divorce.

(8) The failure to find that the payments made by Hans S. Hollander to his former wife during 1948 and 1949 were in discharge of a legal obligation arising out of the marital or family relationship.

(9) Disregarding the order of the Superior Court in and for the County of Los Angeles, State of California.

(10) The finding of deficiency in income taxes for the calendar years 1948 and 1949 in the respective amounts of \$6,866.59 and \$3,947.58.

### **Summary of the Argument.**

#### **I.**

THE 1948 MODIFYING AGREEMENT AND DECREE WERE INCIDENT TO THE DIVORCE OF HANS S. HOLLANDER AND IDY HOLLANDER BECAUSE THEY WERE A REVISION OF THE 1946 AGREEMENT AND DECREE WHICH WERE INCIDENT TO THE DIVORCE.

#### **II.**

PAYMENTS MADE UNDER THE 1948 AGREEMENT WERE IN DISCHARGE OF AN OBLIGATION ARISING OUT OF THE MARITAL OR FAMILY RELATIONSHIP BECAUSE, WHERE A DIVORCED HUSBAND IS UNDER A CONTINUING OBLIGATION TO SUPPORT HIS FORMER WIFE, IMPOSED BY DECREE OR AGREEMENT INCIDENT TO DIVORCE, ANY PAYMENTS MADE TO DISCHARGE THIS OBLIGATION ARE PAYMENTS MADE IN DISCHARGE OF AN OBLIGATION ARISING OUT OF THE MARITAL RELATIONSHIP, EVEN IF THE OBLIGATION IS REVISED BY AN AGREEMENT SUBSEQUENT TO THE DIVORCE.

III.

THE TAX COURT, WHEN IT FOUND THAT THE SECOND AGREEMENT COULD NOT BE INCIDENT TO THE DIVORCE OF THE PETITIONER AND IDY BECAUSE THE SECOND AGREEMENT WAS INCIDENT TO IDY'S REMARRIAGE, COMMITTED ERROR BECAUSE IT INTRODUCED INTO THE STATUTE AN ADDITIONAL AND IRRELEVANT CONDITION FOR FINDING THAT THE SECOND AGREEMENT WAS INCIDENT TO DIVORCE.

IV.

THE TAX COURT COMMITTED ERROR WHEN IT TREATED THE 1946 DECREE AND AGREEMENT AS UNALTERABLE BY MUTUAL AGREEMENT BECAUSE HANS S. HOLLANDER'S CONTINUING MARITAL OBLIGATION UNDER THE ORIGINAL 1946 AGREEMENT AND DECREE WAS SUBJECT TO A VALID MODIFICATION BY MUTUAL AGREEMENT EVEN THOUGH THE 1946 AGREEMENT PURPORTED TO BE A "FINAL" SETTLEMENT.

V.

THE MODIFYING AGREEMENT OF 1948 CONTINUED ON WITHOUT INTERRUPTION HANS S. HOLLANDER'S MARITAL OBLIGATION BECAUSE IT WAS BARGAINED FOR AND VALID LEGAL CONSIDERATION IN THE FORM OF MUTUAL PROMISES SUPPORTED IT. IDY HOLLANDER'S REMARRIAGE 13 DAYS AFTER THE EXECUTION OF THE MODIFYING AGREEMENT OF 1948 WAS BOTH WITHOUT EFFECT UPON HANS S. HOLLANDER'S CONTINUING OBLIGATION OF SUPPORT AND IRRELEVANT TO THIS CONTROVERSY.

VI.

THE OPINION OF THE TAX COURT IS INCONSISTENT WITH LEGISLATIVE POLICY BECAUSE IT PREVENTS TAXPAYERS FROM ADJUSTING THEIR MARITAL OBLIGATIONS IN THE LIGHT OF CHANGING CIRCUMSTANCES.

## ARGUMENT.

### I.

The 1948 Modifying Agreement and Decree Were Incident to the Divorce of Hans S. Hollander and Idy Hollander Because They Were a Revision of the 1946 Agreement and Decree Which Were Incident to the Divorce.

Periodic alimony payments are deductible by a divorced husband (and includible in the former wife's gross income) when such payments satisfy two major statutory requirements: one, that the payments are made pursuant to a decree or a written instrument incident to such divorce or separation; and, two, that the payments are made to the former wife in discharge of a legal obligation imposed upon or incurred by the husband because of the marital or family relationship. (See Argument II.) Sections 22(k) and 23(u) of Internal Revenue Code of 1939. (set out in Appx. A.)

For a number of years, the courts had difficulty with the proper interpretation of the clause "incident to such divorce" and struggled with the question of whether this term should be construed narrowly as referring only to the decree of divorce or more broadly as referring to any written arrangements related to the status of divorce. See *Jane C. Grant v. Commissioner*, 209 F. 2d 430 (2d Cir. 1954), affirming 18 T. C. 1013 (1952); *Commissioner v. Dorothy B. Smith*, 192 F. 2d 841 (1st Cir. 1951), affirming 16 T. C. 639 (1951). This question has now been resolved and the courts, in order to fully effectuate the purposes of the statute, have concluded

that the phrase "incident to such divorce" in Section 22(k) refers to the status of divorce rather than to merely the decree of divorce; that the term "written instrument incident to such divorce or separation" was only designed to insure adequate proof of the existence of the obligation when divorce has occurred. *Newton v. Pedrick*, 212 F. 2d 357 (2nd Cir. 1954), reversing 115 Fed. Supp. 368 (S.D.N.Y. 1953); *Maurice Fixler*, 25 T. C. 1312 (1956), Acq. 1956 Int. Rev. Bull. No. 33, 5. Thus, it has now been frequently held that if an existing agreement that was incident to divorce is modified, the modifying agreement is itself incident to divorce. *Newton v. Pedrick*, *supra*; *Dorothy B. Smith v. Commissioner*, *supra*; *Jane C. Grant v. Commissioner*, *supra*; *Antoinette L. Holahan v. Commissioner*, 222 F. 2d 82 (2nd Cir. 1955), affirming 21 T. C. 451 (1954); *Walsh v. Westover*, ..... Fed. Supp. ..... (S.D. Calif. 1953), 53-1 U. S. T. C. para. 9283; *Raoul Walsh*, 21 T. C. 1063 (1954), Acq. 1954-2 Cum. Bull. 6; *Maurice Fixler*, *supra* (first agreement oral not written); *Rowena S. Barnum*, 19 T. C. 401 (1953); Cf., *George R. Joslyn v. Commissioner*, 230 F. 2d 871 (7th Cir. 1956), reversing in part and affirming in part 23 T. C. 126 (1954); *Jessica S. Mahana*, 88 Fed. Supp. 285 (Ct. Cl. 1950), cert. denied 339 U. S. 978 (1950).

The applicable rule of law is as the Court of Appeals for the Second Circuit stated in its holding in *Newton v. Pedrick*, *supra*:

" . . . where a legal obligation to support survives the dissolution of the marital relationship whether

because of imposition in the divorce decree itself or because of a pre-decree agreement not incorporated in the decree, subsequent adjustment of that obligation by a court order or by later agreement is 'incident to such divorce' within the purview of the statute." (212 F. 2d 358 at 361-362.)

On March 16, 1948, Hans S. Hollander was under a continuing obligation to support his former wife, Idy. This obligation was imposed by a decree of divorce and an agreement incident to divorce and was an obligation arising out of the family or marital relationship. The Commissioner of Internal Revenue does not question that payments under this original agreement were properly deducted by petitioners.

On March 16, 1948, Hans S. Hollander and his former wife, Idy, revised the form of Hans S. Hollander's continuing support obligation by an agreement which was bargained for and supported by valid legal consideration, and which agreement was subsequently incorporated into a judicial decree. [R. 16-17.]

As the March 16, 1948, agreement revised the 1946 decree and written agreement which was incident to divorce, at a time when the obligations under the 1946 agreement were in full force and effect, the 1948 agreement was incident to divorce and the payments pursuant to it were deductible.

II.

Payments Made Under the 1948 Agreement Were in Discharge of an Obligation Arising Out of the Marital or Family Relationship Because, Where a Divorced Husband Is Under a Continuing Obligation to Support His Former Wife, Imposed by Decree or Agreement Incident to Divorce, Any Payments Made to Discharge This Obligation Are Payments Made in Discharge of an Obligation Arising Out of the Marital Relationship, Even if the Obligation Is Revised by an Agreement Subsequent to the Divorce.

In addition to the much litigated requirement that alimony payments be made pursuant to a decree or written instrument "incident to such divorce," Sections 22(k) and 23(u) (set out in Appx. A), contain the second requirement that payments to be deductible must be "in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by" the divorced husband. Legislative history indicates that the legal obligation to which the statute refers must be in recognition of the general obligation to support the former wife. See Sen. Rep. No. 1631, 77th Cong., 2d Sess. 84 (1942); *Newton v. Pedrick*, 212 F. 2d 357 at 361.

The courts have held that where a divorced husband is under a continuing obligation to support his former wife imposed by decree or agreement incident to divorce, any payments made in discharge of this obligation are payments made in discharge of an obligation arising out of the marital or family relationship, even if the obliga-

tion is revised by an agreement subsequent to the divorce. *Newton v. Pedrick, supra; Dorothy B. Smith v. Commissioner, supra; Jane C. Grant v. Commissioner, supra; Antoinette L. Holahan v. Commissioner, supra; Walsh v. Westover, supra; Raoul Walsh, supra; Rowena S. Barnum, supra; Cf., Maurice Fixler, supra; George R. Joslyn v. Commissioner, supra; Jessica S. Mahana, supra.* The courts have reached this conclusion because:

“there is nothing in the statute or legislative background which suggests that it was intended that the equitable distribution of the tax burdens resulting from the adjustment of marital or family financial obligations in connection with a dissolution of the marriage relationship, which the statute aimed to achieve, should be limited to those arrangements effected at the time of decree of divorce or separation, without regard to their possible future rearrangement in consequence of later and perhaps unforeseen vicissitudes.” (*Newton v. Pedrick, 212 F. 2d 357 at 361.*)

Thus, because on March 16, 1948, Hans S. Hollander’s obligation of support under the 1946 agreement and decree, which obligation clearly and unquestionably arose out of the family or marital relationship, was in full force and effect, the modification of that continuing support obligation retained the same tax characteristics as the original obligation and arose out of the family or marital relationship.

The facts of one of the leading cases in this area are sufficiently close to the facts of the instant case to suggest their elaboration. This is the case of *Newton v. Pedrick, supra*, where the Court of Appeals for the Second Circuit permitted a husband to deduct payments made to

his wife after her remarriage under a modified support agreement. In that case, a husband and wife entered into an agreement in 1924 in contemplation of divorce. The 1924 agreement provided for the support of the wife and children by providing that the wife would receive \$24,000.00 a year until her death or remarriage, and that upon her remarriage she would receive \$14,000.00 a year, plus \$5,000.00 for each child. On August 25, 1926, the wife remarried. In 1928, the agreement was modified to provide for divided custody of the children and an additional \$6,000.00 per year to be paid to the ex-wife. In 1930, another agreement was entered into giving the husband sole custody of the children and cancelling the 1928 agreement and restoring the 1924 agreement as it originally stood, providing, that the husband was required to pay the ex-wife \$11,000.00 per year *in addition to* the payments due under the 1924 agreement. The Court held the payments under the 1930 agreement were deductible by the husband.

Several aspects of the *Newton v. Pedrick* decision are worth emphasis. In *Newton v. Pedrick*, the wife had already remarried at the time the modifying agreement was entered; the husband's original 1924 obligation to make the larger payments, \$24,000.00 per year, required until a remarriage by the wife, had already been reduced by the remarriage of the wife to \$14,000.00 per year, at the time the 1930 modifying agreement was executed. In the instant case, Idy Hollander had not remarried, and most crucially, might never have remarried so as to end Hans S. Hollander's obligation to make the larger payments required until a remarriage by his ex-wife. In *Newton v. Pedrick*, the 1928 modifying agreement increased the divorced husband's payments to \$20,000.00 per

year; the 1930 agreement further increased the payments to \$25,000.00 per year. In *Newton v. Pedrick*, the payments under the modifying agreement were unquestionably *in addition to* the amounts the husband was obligated to pay under the original 1924 agreement. In the instant case, the payments under the modifying agreement by Hans S. Hollander reduced both the annual amount of the continuing obligation and the likely duration of such payments. In short, in line with *Newton v. Pedrick*, the instant case clearly falls within the well established principle of law applicable to this case.

### III.

The Tax Court, When It Found That the Second Agreement Could Not Be Incident to the Divorce of the Petitioner and Idy Because the Second Agreement Was Incident to Idy's Remarriage, Committed Error Because It Introduced Into the Statute an Additional and Irrelevant Condition for Finding That the Second Agreement Was Incident to Divorce.

No court previously has analyzed the problem of deductibility of periodic alimony payments under a modifying agreement except in terms of whether the modifying agreement was "incident to such divorce." *Newton v. Pedrick*, *supra*; *Dorothy B. Smith v. Commissioner*, *supra*; *Jane C. Grant v. Commissioner*, *supra*; *Antoinette L. Holahan v. Commissioner*, *supra*; *Walsh v. Westover*, *supra*; *Raoul Walsh*, *supra*; *Maurice Fixler*, *supra*; *Rowna S. Barnum*, *supra*; Cf., *George R. Joslyn v. Commissioner*, *supra*; *Jessica S. Mahana*, *supra*. If the modifying agreement is "incident to such divorce," *i. e.*, related to the status of divorce, then until now it has been irrelevant what other things the modification is incident to or related

to. In this respect, the Tax Court committed error by finding that "the second agreement was not incident to the divorce of petitioner and Idy, but incident to Idy's remarriage." [R. 62.]

Perhaps, from Idy's standpoint, her motive in modifying the original agreement was principally related to her possible remarriage. But because Idy (or even Idy and Hans S. Hollander), had as her (their) motive for agreeing to a modifying agreement her possible remarriage does not mean that such agreement could not also be incident to the prior divorce of Idy and Hans S. Hollander. And, more importantly, if the modifying agreement was incident to such prior divorce, then it could not be material or relevant what else such agreement was incident or related to, or what other motives the taxpayers had. Surely, there is no statutory requirement that a modifying agreement be incident to the divorce and only incident to the divorce; that such agreement not be incident to or related to anything else. It would be unrealistic and unduly harsh to require parties to be so single minded in their subjective motives. Yet, this is what the Tax Court appears to demand.

By stating that the modifying agreement was "incident to Idy's remarriage" [R. 62], the Tax Court demonstrated a misconstruction of the problem of the case and a confusion of the ultimate fact for the Court's determination. The ultimate fact in a case involving a modifying agreement, is as the Court of Appeals for the Second Circuit in *Newton v. Pedrick, supra*, held:

" . . . where a legal obligation to support survives the dissolution of the marital relationship . . . , subsequent adjustment of that obligation by a court

order or by later agreement as the case may be, is 'incident to such divorce' within the purview of the statute." (212 F. 2d 357 at 361-362.)

That Court also said:

"The fact that increased support for the wife may have given the husband an opportunity to adjust the custody arrangements hardly proves that the motive for the 1930 Property Agreement (the modifying agreement) was other than a 'marital' or 'family' one." (212 F. 2d 357 at 360.)

The Tax Court in this case should have centered its inquiry on whether the modifying agreement was incident to divorce and made that the pivotal issue. If the issue of whether the modifying agreement was incident to divorce had been properly delineated from incidental factors, such as the parties' subjective motives, it would have been necessary to decide that the 1948 modifying agreement and decree were incident to the divorce of Hans S. and Idy Hollander because they were a revision of the 1946 agreement and decree which were incident to the divorce.

The same sort of distinction as the distinction on which the Tax Court based its decision in this case, prompted the Second Circuit Court of Appeals to exasperatedly declare that:

". . . our repeated decisions on this subject have been founded upon principles which make irrelevant such incidental matters as those now held by the Tax Court to be decisive." (*Harold Holt v. Commissioner*, 226 F. 2d 757 at 758 (2nd Cir. 1955), reversing 23 T. C. 469 (1954), cert. denied 350 U. S. 982 (1956).)

IV.

The Tax Court Committed Error When It Treated the 1946 Decree and Agreement as Unalterable by Mutual Agreement Because Hans S. Hollander's Continuing Marital Obligation Under the Original 1946 Agreement and Decree Was Subject to a Valid Modification by Mutual Agreement Even Though the 1946 Agreement Purported to Be a "Final" Settlement.

The Tax Court, while seeming to accept the principle that "where a divorced husband is under a continuing obligation to support his former wife, imposed by a decree or agreement incident to divorce, any payments made to discharge this obligation are payments made in discharge of an obligation arising out of the marital or family relationship, even if the obligation is revised by an agreement subsequent to divorce" [R. 59], sought to make that principle inapplicable to the instant case on the ground that there was no "continuing obligation" which could be modified in the instant case because the original agreement purported to be a "final" one. [R. 59-61.]

In this regard, the Tax Court went to great lengths in its opinion to distinguish the instant case from the case of *Dorothy B. Smith v. Commissioner, supra*, where the modifying agreement was held incident to the divorce. The Tax Court said:

"Unlike the 1937 agreement in the *Smith* case, the 1946 agreement here did not leave open the final disposition of the amount of support to which petitioner's former wife could be entitled." [R. 60-61.]

Although there is some supporting dictum in the *Smith* case for the Tax Court's assertion, see 192 F. 2d 841 at 844, the Tax Court's distinction appears to be based upon an erroneous reading of the *Smith* case. In the *Smith* case, husband and wife entered into an agreement in 1937 whereby the wife was to receive \$12,000.00 annually as alimony and for child support until she (1) died, (2) remarried, or (3) the child of the marriage reached twenty-one. Whenever the first of these three events occurred, the parties agreed to modify their agreement. The 1937 agreement then went on to say: "Except as herein provided, neither party shall apply to any Court for the modification of the provisions of this paragraph with respect to such monthly payments." (16 T. C. 639 at 640.) In 1944, at which time none of the aforementioned contingencies had occurred, the wife sought to obtain court enforcement of the husband's obligation to make payments, and the husband sought modification of the original agreement. A new agreement was subsequently entered into to reduce the amount of the husband's payments to the wife and providing for separate payments for the children. Under the terms of the original agreement, modification was only left open upon the happening of the three specified contingencies referred to above; in all other respects, the first agreement was to be final. At the time that the modification was agreed upon, none of these contingencies had taken place; thus the original agreement was in effect modified at a time when it was supposedly final, just as in the instant case; and the modification took place by mutual agreement, just as in the instant case.

None of the following cases, all of which hold payments by a husband under a revised agreement to be deductible, inquire into whether the original agreement purported to be a "final" one or only a tentative settlement. *Newton v. Pedrick, supra*; *Jane C. Grant v. Commissioner, supra*; *Antoinette L. Holahan v. Commissioner, supra*; *Walsh v. Westover, supra*; *Raoul Walsh, supra*; *Rowena S. Barnum, supra*.

The reason the foregoing cases were not concerned with purported "finality" is that the language of finality in a settlement agreement is used only to prevent harassment of one party by unilateral petition on the part of the other party to a court to upset the mutually agreed upon arrangement of the parties. The merit of having such a finality provision in an agreement is that it gives the parties certainty in their parting arrangements. However, changing circumstances frequently dictate renegotiating the terms of a purportedly "final" settlement. In such situations, because of the inability of either party to revise the parting arrangements upon a unilateral petition to a court, it becomes very important from the standpoint of public policy to allow revision in the light of changed circumstances upon the mutual consent and agreement of the parties. This the Tax Court would deny. And this the Superior Court of the State of California recognized when it ordered Hans S. Hollander to make payments under the modifying agreement of 1948. [R. 17, 42-43.] To conclude, even a purportedly "final" agreement is subject to a valid modification by mutual agreement.

V.

The Modifying Agreement of 1948 Continued on Without Interruption Petitioner Hans S. Hollander's Marital Obligation Because It Was Bargained for and Valid Legal Consideration in the Form of Mutual Promises Supported It. Idy Hollander's Remarriage 13 Days After the Execution of the Modifying Agreement of 1948 Was Both Without Effect Upon Hans S. Hollander's Continuing Obligation of Support and Irrelevant to This Controversy.

The Tax Court in its opinion seems to treat the 1948 agreement as being unsupported by legal consideration on the ground that there was no evidence "that Idy would not remarry unless petitioner acquiesced in continuing the alimony payments" [R. 62] and on the ground that Hans S. Hollander had already obtained informal custody of the child. [R. 62.] This position of the Tax Court misconstrues the problem. It is not significant what Idy Hollander would have done in the event Hans S. Hollander did not agree to the modifying agreement. Only if Idy Hollander had remarried *prior* to March 16, 1948, could such remarriage have been relevant to the problem of consideration, for then Hans would have been relieved of any continuing obligation to support her. If Idy Hollander had already remarried when the modifying agreement was executed, then the Tax Court would have been justified in treating the facts as if Hans S. Hollander reassumed obligations of which he had been relieved or assumed additional burdens which had never before existed. But such treatment must be considered error when the facts are to the contrary—on March 16, 1948, Idy Hollander had not remarried and might never have remarried. [R. 16-17.] On March 16, 1948, Hans S.

Hollander's continuing obligation to support Idy Hollander for the rest of her natural life was unimpaired and in full force and effect. Even though petitioner knew that Idy Hollander was strongly considering remarriage, it was a fact that on March 16, 1948, Idy Hollander had not only not remarried, but might never have remarried for any number of reasons. Compare *E. Ellsworth Baker v. Commissioner*, 205 F. 2d 369 at 370 (2nd Cir. 1953), affirming in part and reversing in part 17 T. C. 1610 (1952), (discussing unpredictability of wife's remarriage). Possibly, Idy's prospective husband, or Idy herself, might have died or have been killed in an accident. Even more likely, the prospective husband, or Idy Hollander herself, may have had a change of heart and decided not to remarry. Indeed, the facts stipulate that Hans S. Hollander agreed to the 1948 modifying agreement in order to "enable" Idy's remarriage. [R. 17.] The logical inference to be drawn from this fact and the fact that the prospective husband was "relatively impecunious" [R. 16] is that Idy could *not* and would *not* have remarried unless Hans S. Hollander agreed to this modification and that Hans S. Hollander would have had to support Idy Hollander for the rest of her natural life.

As of March 16, 1948, Hans S. Hollander could only be relieved from his fully enforceable support obligation by securing Idy's consent to relief or by an act (Idy's remarriage) over which Hans had no control and which was entirely within the discretion of two independent parties, Idy and her prospective husband. Thus, the 1948 agreement was the result of a bargained for exchange of mutual promises which saw both parties suffering legal detriments as promisors and receiving legal benefits as promisees. Idy Hollander agreed to the following legal

detriments: (a) reduction in the amount of payment to be given to her annually; (b) termination of all payments after a short specified period of years rather than a continuation of payments for an indefinite period, potentially measured by her natural life; (c) substitution of the child for Idy as beneficiary of the insurance policies, and (d) granting to Hans S. Hollander sole legal custody of the child. In return for these legal benefits, Hans S. Hollander agreed to pay the reduced annual amount to Idy for a specified period of years, whether or not she remarried. [R. 31-41.]

Hans S. Hollander did not reassume any obligations of which he had been relieved because on March 16, 1948, he had been relieved of none of his obligations under the 1946 agreement and decree. [R. 16-17.] Nor can it be said his obligations were voluntarily assumed burdens in the nature of a mere gratuity. As has been shown, the 1948 agreement was bargained for and supported by valid legal consideration.

The error in the Tax Court treatment of the consideration issue becomes even more evident when considering the point of whether securing legal custody of the only child constituted a part of the consideration for the modifying agreement of 1948. The Tax Court in the Hollander case disregarded this facet of the bargain, saying: "That agreement did no more than formalize what had already been accomplished in fact by the parties many months prior to the making of that agreement." [R. 62.] But the fact remains that until Hans S. Hollander received legal custody of the child, the informal arrangement whereby he had temporarily obtained custody of the child could have been upset and Idy Hollander

could have regained actual custody of the child at any time she so desired. Legal custody of the child was not a mere matter of form without substance as the Tax Court implied. It means Hans S. Hollander's securing the right to keep his daughter on a permanent basis rather than under a tentative arrangement which Idy Hollander could unilaterally upset.

The case of *Newton v. Pedrick*, *supra*, is strikingly similar to the instant case in the identity of its facts on this issue and the contrariness of the Tax Court's present decision to that of the Court of Appeals for the Second Circuit. In the *Newton v. Pedrick* case, the wife had already remarried so that securing legal custody of the children was the sole consideration received by the husband for his agreement to pay the former wife *additional* amounts for her support. That Court did not cast aside the significance of securing legal custody but viewed it as an integral part of the "re-shuffling" of the parting marital and family relationship. (212 F. 2d 357 at 360.) The *Newton* case would, indeed, be authority for finding the transfer of legal custody of the child as sufficient consideration in and of itself for Hans S. Hollander's promise to make payments after Idy's remarriage, even if Hans S. Hollander's promise had taken place after and not before, as it in fact did, the remarriage of Idy Hollander. In *Newton*, the wife had remarried and only the transfer of child custody kept the *additional* payments by the husband from being a gratuity.

In addition, as further consideration, Hans S. Hollander obtained the right to substitute his daughter in place of Idy as beneficiary of certain life insurance policies.

To conclude, the modifying agreement was bargained for and supported by traditional legal consideration.

VI.

The Opinion of the Tax Court Is Inconsistent With Legislative Policy Because It Prevents Taxpayers From Adjusting Their Marital Obligations in the Light of Changing Circumstances.

If the position of the Tax Court is sustained, a great many taxpayers having parted company under alimony agreements would be frozen in their position under such agreement. According to the Tax Court, when Idy Hollander approached Hans S. Hollander to renegotiate their separation agreement, Hans S. Hollander should have refused to consider reducing his present obligation through bilateral agreement because unilateral voluntary action on the part of Idy *might* some time in the future end his obligation entirely. [R. 62.] According to the Tax Court, Hans S. Hollander could only consent to reducing his obligation if he could later prove Idy Hollander would not remarry without his consent to a new agreement. [R. 62.] It is submitted this test imposes an unreal burden upon taxpayers. How was Hans S. Hollander to determine that Idy would remarry regardless of his agreement to a modification? What justification is there to place the burden on Hans S. Hollander to determine whether Idy would remarry regardless of his consent to a modifying agreement? What makes the Tax Court believe that Idy Hollander herself knew if she would remarry if Hans S. Hollander would refuse to modify the terms of the original agreement? One of the pivotal factors in Idy's decision to remarry was probably the ability to procure Hans S. Hollander's consent to

a modifying agreement. Indeed, in point of fact, once having been able to successfully bargain for Hans S. Hollander's agreement to a modification, Idy Hollander never had to face the ultimate issue, according to the Tax Court, of whether she would remarry even without modified alimony provisions. The Commissioner has not shown otherwise.

As the Second Circuit said in *Newton v. Pedrick, supra*:

“There is nothing in the statute or its legislative background which suggests that it was intended that the equitable distribution of the tax burdens resulting from the adjustment of marital or family financial obligations in connection with the dissolution of the marriage relationship, which the statute aimed to achieve, should be limited to those arrangements effected at the time of a decree of divorce or separation, without regard to possible future rearrangement in consequence of later and perhaps unforeseen vicissitudes.” (212 F. 2d 357 at 361.)

The Court of Appeals for the Ninth Circuit has recognized the broad construction of, and the overall policy to be implemented by, Sections 22(k) and 23 (u) of the Internal Revenue Code of 1939; in reversing the Tax Court in another case where the Tax Court held an agreement not to be incident to divorce, this Court stated:

“The restricted interpretation given the statutory phrase by the Tax Court would tend, we believe, to defeat in many instances the legislative purpose.” (*Commissioner v. Cecil A. Miller*, 199 F. 2d 597 at 599 (9th Cir. 1952) reversing 16 T. C. 1010 (1951); Non-acq. 1951-2 Cum. Bull. 5.)

### Conclusion.

The payments made by petitioner, Hans S. Hollander, to his former wife, Idy, during 1948 and 1949 were deductible under Section 23(u) of the Internal Revenue Code of 1939 because such payments were in discharge of a legal obligation arising out of the marital or family relationship, which obligation was imposed upon petitioner under a decree of divorce and under a written instrument incident to the divorce. The Commissioner of Internal Revenue's determination of a deficiency for those years should be disapproved, and the Tax Court's decision reversed, and judgment entered for the petitioner.

Respectfully submitted,

IRELL & MANELLA,

LAWRENCE E. IRELL,

LOUIS M. BROWN,

EDWARD SANDERS,

STANFORD G. ROSENBLUM,

*Attorneys for Petitioners.*

## APPENDIX A.

### Internal Revenue Code of 1939.

#### Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

\* \* \* \* \*

(u) Alimony, Etc. Payments—In the case of a husband described in Section 22(k), amounts includable under Section 22(k), in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under Section 22(d) or Section 171, stated to be not includable in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection.

#### Sec. 22. Gross Income.

\* \* \* \* \*

(k) Alimony, Etc., Income—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includable in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includable in the gross income of such husband. \* \* \*







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In the United States Court of Appeals  
for the Ninth Circuit

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No. 15357

HANS S. HOLLANDER AND CLEMENCE BLUM HOLLANDER,  
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

---

*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX  
COURT OF THE UNITED STATES*

---

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 43-63) are reported at 26 T.C. 827.

JURISDICTION

The Commissioner determined deficiencies in income tax for the calendar years 1948 and 1949. The notices of such deficiencies were mailed to the taxpayers on September 9, 1953, and the petition for review by the Tax Court was filed on November 30, 1953. (R. 3-13, 90.) Accordingly, the petition was filed within the ninety-day period allowed by Section 272 of the Internal Revenue Code of 1939. An Answer was filed on

behalf of the Commissioner on January 26, 1954. (R. 13-14, 90.) After the hearing, the Tax Court entered its decision on July 18, 1956, determining deficiencies in income tax for the years 1948 and 1949 in the total respective amounts of \$6,866.59 and \$3,947.58. (R. 63-64, 91.) A petition for review by this Court was filed on October 5, 1956. (R. 64-68, 91.) This Court accordingly has jurisdiction of the case under Section 7482 of the Internal Revenue Code of 1954.

#### QUESTION PRESENTED

Taxpayer<sup>1</sup> and his former wife made an agreement incident to their divorce and providing for the latter's support during her lifetime or until she should remarry, but subsequent to the divorce they made a second agreement which provided for payments for a certain period regardless of her remarriage. The question is whether payments made by the taxpayer under the second agreement and after the remarriage of his former wife can be deducted by him as alimony under Section 23(u) of the Internal Revenue Code of 1939.

#### STATUTE INVOLVED

The pertinent provisions of the statute involved are set forth in the Appendix, *infra*.

#### STATEMENT

The Tax Court adopted the stipulated facts (R. 14-19) and, so far as pertinent here, its findings (R. 45-56) are as follows:

The taxpayer was married to Clemence Blum Hollander (the other petitioner here) on August 5, 1948.

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<sup>1</sup> Mr. Hollander's second wife is also one of the parties in this case, but since she is involved only because they filed joint tax returns we shall generally refer to the husband as the taxpayer.

(R. 55.) Before then he had married Idy Hollander on September 30, 1937, and has one daughter born of that first marriage on August 12, 1940. In contemplation of divorce an agreement was made by taxpayer and Idy on March 6, 1946. Such agreement stated that it was a permanent and final settlement of property or property rights and obligations for support "which each has or may have or owe to the other or to the minor child". (R. 45.) The provisions which it contained for the support and maintenance of Idy are in part as follows (R. 46-48):

2. Upon entry of a valid interlocutory decree of divorce \* \* \* the husband agrees to pay to the wife from and after the entry of said decree \* \* \* an amount equivalent to \$10,000.00 per year, payable at the rate of one-twelfth (1/12) of said amount per month, for alimony, support, maintenance and care of the wife and child; provided, however, that if the amount so payable is greater than one-third (1/3) of the income received by the husband for the year concerned, then said yearly amount shall be reduced to an amount equivalent to said one-third (1/3) of said income so received by the husband, which lesser sum shall likewise be payable one-twelfth (1/12) thereof for each month during the year concerned. \* \* \* Any payments under the provisions of this paragraph 2 shall commence immediately following the entry of said decree and shall continue from and after said date for the remainder of the wife's natural life, or until such time as she shall remarry. If the wife shall remarry, then immediately upon the occurrence of said remarriage, payments as set forth

in this paragraph 2 shall automatically cease, but in the event of such remarriage the husband shall continue to pay for the support of the child so long as the child is a minor in an amount which shall be agreed upon by and between the parties hereto, or, if the parties cannot so agree, as determined by Court. In any event, payments provided for in this paragraph and in paragraph 1 hereof shall automatically cease and terminate upon the death of the husband. \* \* \*

\* \* \* \* \*

9. The husband and wife do hereby release, acquit, and forever discharge the other from any and all claims which he or she now has or may hereafter have against or upon the other for payment of maintenance or alimony excepting as herein provided. Each of the parties hereto agrees that he or she will not under any circumstances ask any court in any divorce or separate maintenance action or otherwise for any allowance for alimony, support and maintenance or for any decree, judgment or order affecting the property rights of the parties hereto other than as provided and set forth in this agreement.

On June 12, 1946, a decree of divorce was entered by a Nevada court in a suit which had been filed by Idy. The agreement of March 6, 1946, was made a part of the decree and the parties were ordered to comply with it. (R. 48; for decree see R. 49-50.)

The taxpayer did perform his obligations under such decree until the second agreement was entered into in 1948. Also, although custody of the daughter had been

granted to Idy, due to various circumstances she had not kept the child but by mutual agreement the latter had lived with the taxpayer after November 1946. That was still the situation when in 1948 Idy made known to the taxpayer the fact that she wished to remarry and the man whom she wanted to marry was "relatively impecunious". Thus, notwithstanding the provision in the first agreement that the alimony payments thereunder were to cease automatically in the event of Idy's remarriage, taxpayer and Idy made a second agreement on March 16, 1948, in which he promised that after her remarriage he would make payments in the amounts and for the period designated therein. Generally stated, the payments were to be \$550 per month from March 1, 1948, until February 1, 1951, and \$250 per month from March 1, 1951, until February 1, 1954, when the payments were to cease, but they were to cease earlier if taxpayer died before the end of such period. (R. 48, 50-52; for specific terms of the agreement see Ex. 2-B, R. 31-41.)

It was stipulated that taxpayer "voluntarily entered into the second agreement of March 16, 1948" in order to enable the remarriage of Idy and to obtain legal custody of his daughter. (R. 17, 50.)

Idy remarried on March 29, 1948. She had become a resident of California subsequent to June 12, 1946 (when her divorce decree was entered in Nevada). About May 18, 1948, taxpayer filed a suit against Idy in the Superior Court in Los Angeles County in order to establish the Nevada decree of divorce as a foreign judgment. Idy agreed to the judgment which was entered in that suit on June 30, 1948, and which not only ordered that the Nevada decree be established as a for-

eign judgment but also ordered that such decree be enforced subject to two modifications, namely, (1) that the agreement between the parties of March 16, 1948, be "ratified, confirmed and approved" and that the plaintiff be ordered to make payments pursuant to such property agreement, and (2) that "until the further order of the Court" the plaintiff be given custody of his daughter Barbara Mia with full rights of visitation by her mother. (R. 54-55.)

During 1948 taxpayer made 12 monthly payments of \$550 each to his former wife, paid \$1,990.40 to the Federal Government on account of her liability for 1947 federal income tax and paid \$67 to the State of California on account of her liability for 1947 California income tax.<sup>2</sup> Taxpayer and his second wife claimed the total amount of \$8,657.40 as an alimony deduction on their 1948 income tax return. But the Commissioner allowed only \$2,057.40 (the sum representing the amounts paid by taxpayer on account of Idy's 1947 liability for federal and California income taxes) and \$1,650 (the total of payments made to Idy during the first three months of 1948). The balance of \$4,950 claimed by taxpayers for 1948 was disallowed. (R. 55-56.)

During 1949 taxpayer made 12 monthly payments of \$550 each to Idy, paid \$1,225.44 and \$42, respectively, to the Federal Government and the State of California on account of her liability for income taxes for 1948. (R. 56.) Taxpayers claimed the total amount (\$7,-

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<sup>2</sup> The 1946 agreement provided for the withholding by petitioner of amounts necessary to pay all income taxes which might be assessed against Idy on account of the payments to be made under the agreement. The 1948 agreement contained a similar provision. (R. 55.)

867.44) as an alimony deduction on their 1949 return, and the Commissioner disallowed the deduction.

The Tax Court approved the Commissioner's determination and found deficiencies in income tax for the years 1948 and 1949 in the respective amounts of \$6,-866.59 and \$3,947.58. (R. 63-64.)

#### SUMMARY OF ARGUMENT

Payments made by a taxpayer for the support of his divorced wife are deductible on his income tax return if such payments are periodic and have been made in discharge of a legal obligation which, because of the marital or family relationship, has been imposed upon, or incurred by, him under a decree or under a written instrument incident to the divorce. The Tax Court correctly held that these requirements were not met by the taxpayer here.

The payments here were made to taxpayer's divorced wife under their second agreement which, unlike the first agreement, provided for payments to the wife for six years and regardless of whether she should remarry. However, she did remarry shortly after execution of the second agreement, and it has been stipulated that her desire to remarry and to have additional support payments because she wished to marry a "relatively imppecunious" man were the basic reasons for the second agreement. Thus the Tax Court properly held that such agreement was not incident to the divorce, as required by the statute, but was incident to the wife's remarriage. The Tax Court also correctly pointed out that the second agreement provided for payments for which there was and could be no obligation under the first agreement since payments automatically ceased under that agreement when the wife remarried. The parties

had intended such arrangement to be a final property settlement and included a statement to that effect in the first agreement which was incorporated in the Nevada divorce decree. Consequently, in making the second agreement in order to enable the wife to remarry, the parties were not merely reshuffling or readjusting the obligation originally imposed for the wife's support but were providing for a new non-support obligation and were acting so that the wife could acquire a new status.

Taxpayer's major contention is that the second agreement should be treated as being incident to the divorce because the first agreement was incident to the divorce. But that is not so here because, as already indicated, the obligation in the second agreement was not imposed by (or a revision of) the first, and the payments thereunder did not discharge any support obligation within the meaning of the applicable statutory provisions. Moreover, the cases cited by the taxpayer did not announce as a general principle that any subsequent agreement must be treated as incident to a divorce if the original agreement is incident to the divorce, and all of the cases relied on are distinguishable on their facts.

The crucial and undisputed fact here, which completely distinguishes this case from those relied upon by taxpayer, is that the legal *obligation to support* incurred by him under the original pre-divorce agreement was, by the very terms of that agreement, to terminate upon the happening of a specified contingency—the wife's remarriage. By purporting to obligate himself in the post-divorce "revisionary" agreement to continue to support the wife subsequent to and

*notwithstanding her remarriage*, taxpayer gratuitously undertook to *revive* a support obligation of which he had already expressly relieved himself by a valid and final pre-divorce settlement agreement with the wife. To permit the husband in the guise of post-divorce alimony revisionary agreements to deduct such voluntary support payments would defeat the legislative intent, apparent from the language and history of Sections 22(k) and 23(u) of the Internal Revenue Code of 1939, to confine the deduction to support payments made "in discharge of a legal obligation" imposed upon the husband.

#### ARGUMENT

##### **The Tax Court Correctly Held That the Taxpayer Is Not Entitled to Deduct Payments Made to His Divorced Wife Under Their Agreement Entered Into Subsequent to the Divorce**

The taxpayer here claims the right to deduct the payments which he made to his divorced wife during 1948 and 1949 after execution of their agreement on March 16, 1948. It is conceded that if these payments are deductible it is because of the privilege granted by Section 23(u) of the Internal Revenue Code of 1939 (Appendix, *infra*) which provides, in substance, that deductions may be taken by a divorced husband under the conditions set forth in Code Section 22 (k) (Appendix, *infra*), and that such deductions may equal amounts which are includible under the latter section in the gross income of the divorced wife. Pertinent provisions of Section 22 (k) are as follows:

In the case of a wife who is divorced \* \* \* from her husband under a decree of divorce \* \* \* periodic payments \* \* \* received subsequent to such decree \* \* \* in discharge of, a legal obligation

which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includable in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includable in the gross income of such husband. \* \* \*

It will be seen that in order for the payments made by a divorced husband to come within the provisions of Section 22 (k) he must show, among other things, that such payments have been made in discharge of a legal obligation which, because of the marital or family relationship, has been imposed upon, or incurred by, him under a decree or under a written instrument executed incident to the divorce. The Commissioner determined that these requirements had not been met by the taxpayer here and the Tax Court agreed. Thus it held that the payments here are not within the contemplation of Section 22(k) and therefore are not deductible under Section 23 (u).

*A. The payments here were not made under an agreement executed incident to the divorce as required by the statute*

The payments involved here were made by the taxpayer to Idy, his divorced wife, under their second agreement executed on March 16, 1948, which was only 13 days before her remarriage. (R. 17-18.) The Tax Court found (R. 62) that such agreement was not incident to their divorce, as required by Section 22 (k), but was incident to Idy's remarriage. That finding is amply supported by the terms of the agreement and

the facts leading up to its execution. Moreover, such finding is a proper basis for the Tax Court's conclusion that payments under the second agreement did not come within the purpose or intent of the first agreement of March 6, 1946, which was incorporated as a part of the divorce decree entered on June 12, 1946, and was incident to the divorce. (R. 17, 48-51, 62.)

In reaching that conclusion the Tax Court pointed out (R. 61) that under the second agreement taxpayer agreed to make payments to his former wife *for which there was and could be no obligation under the first agreement.* The correctness of the Tax Court's statement cannot be denied. Under the first agreement payments for Idy's support (as designated therein) were to continue for the remainder of her natural life or "until such time as she shall remarry", and if she "shall remarry, then immediately upon the occurrence of said remarriage" the payments for her support "shall automatically cease". (R. 23.) That this arrangement was intended to be a final settlement is specifically indicated in paragraph 9 of the agreement providing that both parties "do hereby release, acquit, and forever discharge the other from any and all claims" for payment "of maintenance or alimony" except as allowed therein and that each agreed not to ask any court "under any circumstances" for any allowance for support except as provided in the agreement. (R. 28.)

It is also evident that the Nevada court which granted the divorce treated the first agreement as a final settlement of Idy's right to support. The divorce decree states (R. 49-50) that jurisdiction is being re-

tained only for the purpose of making any further order which might be necessary for the custody of the daughter and there is no contention here that any attempt has ever been made or could have been made successfully to change the Nevada decree.<sup>3</sup> Thus the divorce decree must be accepted as rendered and it not only states that the agreement of March 6, 1946, "is hereby ratified, confirmed and approved by this Court and made a part of this decree", but also orders that "the parties hereto comply with all the requirements contained in the above-mentioned property settlement agreement". (R. 49.)

Notwithstanding the terms of the divorce decree and the agreement incorporated therein, the taxpayer and Idy made a second agreement about two years later in which he promised to make monthly payments until February 1954 to the extent designated therein and even though Idy did remarry. (R. 32-41.) But in taking such action they were not merely reshuffling the original divorce arrangements, as taxpayer argues here. Instead, the second agreement imposed a new obligation on the taxpayer and was entered into not for the purpose of carrying on the divorce status but

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<sup>3</sup> On June 30, 1948, an order which established the Nevada divorce decree as a foreign judgment was entered by a California court in a suit filed by taxpayer against his divorced wife. The latter did not enter an appearance and there is nothing to indicate that there was any controversy on which such suit could be based. Certainly the order is open to question for, although it purported to approve the Nevada decree, it did not in fact do so. Instead, it ordered that such decree "be enforced in this action subject to modifications" of the second agreement. (R. 43.) In doing this the California court was exceeding its authority if it was attempting to modify the Nevada decree and apparently taxpayer agrees, for he does not seem to rely here on the order of the California court and we submit that it has no materiality in determining the issue here.

to enable Idy to cast off that status. That this is so is shown both by the stipulation of facts and by the provisions of the second agreement.

The parties here have stipulated that, subsequent to the divorce, Idy made known to the taxpayer that "she desired to remarry"; that the person whom she desired to marry was "relatively impecunious"; that under the first agreement taxpayer "would be relieved of further alimony obligations" upon her remarriage; and that "In order to enable the remarriage of Idy" and to obtain legal custody of his daughter, taxpayer "voluntarily entered into the second agreement of March 16, 1948". (R. 16-17.) These stipulated facts are in effect an admission that taxpayer understood that his legal obligation for support was not a continuing one, i.e., was not to survive Idy's remarriage, and that he had *voluntarily* agreed to help Idy so that she could get married again. This is also shown by the provisions of the second agreement, which pointed out in clear and unmistakable language that the reason for entering into the agreement was that Idy desired to remarry and wished that taxpayer's payments to her be continued, and that the taxpayer was willing to make payments for the number of years and amounts designated therein. (R. 32-33.)

We submit that in view of the provisions in the second agreement just referred to and other facts relevant thereto the Tax Court correctly held that such agreement was not incident to the divorce, and that the payments thereunder have not been made in discharge of a legal obligation which, because of the marital relationship, was imposed on the taxpayer.

*B. Errors in taxpayer's argument*

The taxpayer's principal contention is that the second agreement was incident to the divorce because it was merely a revision of the first agreement which was incident to the divorce. We do not of course agree that the second agreement was merely a revision of the first and neither did the Tax Court. Even the taxpayer appears to concede that the second agreement was incident to Idy's remarriage or at least admits (Br. 17) that her contemplated remarriage was the motive for that agreement. However, the taxpayer asserts that the Tax Court was in error in centering its attention on Idy's remarriage and should have given more consideration to the question of whether the second agreement modified the first one. Thus taxpayer argues (Br. 16-18) that the Tax Court misconstrued the issue to be determined here and also failed to take the required realistic approach. But we submit it is the taxpayer who is in error. The Tax Court carefully analyzed both agreements and not only recognized that the question to be determined was whether the second one was merely a modifying agreement but answered that question. Its answer was that, since there was no continuing obligation for support under the first agreement and taxpayer's obligation ended with Idy's remarriage, the second agreement was not a modification or revision of any obligation imposed by the first. Moreover, it held that that was true regardless of certain language indicating that the parties were thereby settling taxpayer's obligation to support imposed by the first agreement. Such language may have been inserted to strengthen the taxpayer's position for income tax purposes but, whether or not that was its purpose, the Tax

Court correctly construed the second agreement and held that it was not in fact a revision of the first but that it imposed a new obligation. As to this the Tax Court said (R. 61-62) :

Although the second agreement contained words to the effect that it was in settlement of petitioner's obligations for alimony under the first agreement, there could under the first agreement be no liability for the payments here in question. The decree of divorce and the 1946 agreement incorporated therein had specified with particularity that petitioner should have no obligation to support Idy after her remarriage. The 1948 agreement, however, is bottomed on her contemplated remarriage and to a man apparently incapable of supporting her in keeping with her tastes or desires. It thus appears, we think, that the second agreement was not incident to the divorce of petitioner and Idy, but incident to Idy's remarriage, and the payments made thereunder were not only not within the purpose or intent of the first agreement but petitioner's non-liability for such payments, to borrow from the words of the agreement, had been permanently and finally settled.

It is also obvious that the Tax Court did not give undue emphasis to Idy's proposed remarriage. Since that was the admitted motive for the second agreement the Tax Court was required to consider it, and the weight which it gave to Idy's remarriage is merely the result of a realistic approach, which taxpayer contends should be made.

In other words, in analyzing the situation here the

Tax Court considered these facts: The taxpayer's former wife wanted to marry a man whom she thought was financially unable to support her as she wished to be supported; she knew that under their agreement she could not require the taxpayer to help support her when she became another man's wife; nevertheless she appealed to the taxpayer to do something for her over and above what he had agreed to do and he was generous enough to help her by promising to make payments for six years under certain conditions set out in the second agreement. (R. 31-41.) Thus, viewing the situation realistically, the Tax Court properly concluded that the second agreement was not entered into in furtherance of their divorce but was entered into to help Idy change her status from that of a divorced woman to that of a married woman.

We are of course aware, as taxpayer points out (Br. 23), that Idy had not remarried on March 16, 1948. But she was married 13 days later, and there is no basis for assuming that she would have given up the lifetime payments and other benefits under the first agreement (R. 19-31) if she had not had definite plans for an early remarriage. Certainly both taxpayer and Idy intended that this new agreement should cover the first years of her remarriage and such agreement was in fact incident to that event. Consequently taxpayer is the one who is not being realistic when he asserts (Br. 22) that it is material that when the second agreement was executed he had not yet been relieved of his obligation under the first agreement and that such obligation was a continuing one. As we have pointed out, taxpayer's obligation could continue only to the time of Idy's remarriage, and the reason he was willing to make another agreement was that he knew of her plans to remarry.

Thus, because of the new status which Idy intended to, and did, acquire within 13 days, taxpayer knew his *obligation to support her* was ending. And, as the Tax Court stated (R. 62), there is nothing in the record here to show that Idy would not have remarried if the taxpayer had not made the second agreement. Consequently, what the taxpayer did was to assume a new non-support obligation under an agreement with a purpose and terms different from those of the first agreement.

As the Tax Court also pointed out (R. 62), prior to the 1948 agreement taxpayer had already obtained custody of their daughter by mutual agreement and that arrangement was merely formalized by the 1948 agreement. But, even if Idy's promise to allow the taxpayer to have custody of the daughter should be treated as consideration for the agreement, it is still evident that the payments under this second agreement were not for the *support* of a divorced wife within the purview of Sections 22(k) and 23(u).

### C. *The cases taxpayer relies on are distinguishable*

Taxpayer cites (Br. 11) a number of cases in support of its major contention that an agreement is incident to divorce if it modifies an agreement which is incident to the divorce. But the facts in the cases relied on are distinguishable from those here.

In *Newton v. Pedrick*, 212 F. 2d 357 (C.A. 2d), which appears to be the case primarily relied on, the original agreement, which was incident to the divorce, required the taxpayer to make payments to his former wife of \$24,000 annually for life or until her remarriage and of \$14,000 annually after her remarriage. Thus the

taxpayer had a continuing obligation to make payments even after her remarriage, which was not true here. Consequently, when the parties in the *Newton* case made another agreement some years after the wife's remarriage and provided for an \$11,000 increase in annual payments, there was and could be no question as to whether the taxpayer's obligation was affected in any way by the remarriage of his former wife. As the Second Circuit properly held, the last agreement in that case was incident to the divorce because it had merely modified the original agreement which was incident to the divorce. But, in reaching that conclusion, the court said (p. 361):

We hold no more than that where a legal obligation to support survives the dissolution of the marital relationship—whether because of imposition in the divorce decree itself, or because of a pre-decree agreement not incorporated in the decree \* \* \* a subsequent adjustment of that obligation by a court order or by later agreement, as the case may be, is "incident to such divorce" within the purview of the statute.

We submit that in making the above statement the Second Circuit plainly indicated that, to be incident to a divorce, a second agreement which is subsequent to the divorce must be merely an adjustment of an obligation which has survived the divorce. In the instant case the second agreement was not a mere adjustment because the only obligation which had been imposed on the taxpayer by the divorce decree and the first agreement was one to support the former wife so long as she remained unmarried. Consequently, when

taxpayer promised in the second agreement to go beyond that he assumed a new obligation.

Another case relied on by taxpayer is *Smith v. Commissioner*, 192 F. 2d 841 (C.A. 1st). In that case the parties entered into an agreement in 1937 which provided for support payments to be made to the taxpayer for her lifetime or until she remarried and there was also provision for modification of the agreement after the happening of certain events. Later in 1944, after taxpayer's former husband failed to make the payments and he asked the divorce court for a modification of the alimony payments, the parties compromised their differences by making another agreement in which the taxpayer agreed to accept the payments provided for therein in lieu of the payments under the first agreement. The First Circuit, affirming the Tax Court, held that the 1944 agreement was a revision of the first and that it was incident to the divorce because the first one had been so construed. Thus it held that the taxpayer was taxable on the sums received thereunder. Inasmuch as the taxpayer here asserts (Br. 19-20) that the Tax Court has not properly interpreted the *Smith* case and has relied on "dictum", we call attention to the actual basis for the First Circuit's decision. It said (p. 844):

The criticisms of the petitioner as to the findings of fact by the Tax Court are without merit. Her arguments appear unduly technical and unrealistic in the circumstances here. The 1937 agreement clearly indicates that it was not regarded by either party as final and that subsequent changes were contemplated. The finding that the 1944 agreement was "supplemental" and a "revision" of the

1937 agreement was on the facts here a proper characterization. The 1944 agreement did cancel the 1937 agreement but that is not conclusive. It merely indicates that the parties reappraised their positions and altered circumstances and then agreed to different and changed terms. The genesis of the 1937 and 1944 agreements were the same —a satisfaction by the husband of his marital obligation which continued after the divorce. It follows, therefore, that since the 1937 agreement was incident to the divorce decree, being specifically mentioned therein, that the 1944 agreement was also incident thereto. In fact, the decree of January 14, 1946 specifically mentions the September 1, 1944 agreement.

From the above quotation it is evident that the taxpayer there, who had not remarried, had at all times a right to payments for her support after dissolution of the marriage. Thus the husband's obligation in that case was a continuing one and his payments to his former wife were under an agreement entered into incident to the divorce. The situation here is obviously different.

In two other cases cited by the taxpayer (*Grant v. Commissioner*, 209 F. 2d 430 (C.A. 2d), and *Holahan v. Commissioner*, 222 F. 2d 82 (C.A. 2d)) the primary question was whether a taxpayer must treat a lump-sum support payment, which was made by her divorced husband under an agreement entered into subsequent to the divorce, as a periodic taxable payment under Section 22 (k); and the Second Circuit held in both cases that the wives must do so because these lump-sum payments represented the payments of alimony.

mony arrears which the divorced husbands had failed to make under the original agreements, which were incident to the divorcees. But in the instant case there is no such lump-sum payment involved and no payments in discharge of the obligation imposed under the original agreement, as was true in the *Holahan* and *Grant* cases.

The circumstances here are also clearly different from those in *Walsh v. Westover* (S.D. Cal.), decided March 23, 1953 (1953-1 U.S.T.C., par. 9283), in which support payments for the taxpayer's divorced wife were twice reduced by agreements entered into some years after the entry of the divorce decree and execution of the original agreement, which provided for weekly payments with no condition attached except that the wife must support the two minor children. As the District Court found that the original agreement there was incident to the divorce it also reached the same conclusion as to the two subsequent agreements, which had merely reduced the amounts previously allowed. Thus it held that the taxpayer could deduct the payments involved there under Section 23(k), but the opposite conclusion was reached in an earlier case brought by the taxpayer's wife. *Commissioner v. Walsh*, 183 F. 2d 803 (C.A.D.C.). See also *Commissioner v. Murray*, 174 F. 2d 816 (C.A. 2d).

We are aware that since the Court of Appeals for the District of Columbia decided the *Walsh* case several courts have taken a more liberal view of the term "incident to divorce" and have held that such term does not have to be interpreted as if it read incident to a divorce decree. See *Commissioner v. Miller*, 199 F. 2d 597 (C.A. 9th), and *Feinberg v. Commissioner*, 198

F. 2d 260 (C.A. 3d). But it should be noted that although a more liberal view is now generally approved, the Third Circuit indicated in the *Feinberg* case (p. 263), as it had earlier in *Cox v. Commissioner*, 176 F. 2d 226, 229, that to be incident to divorce an agreement should be a "part of the package of the divorce". The facts in the *Cox* case are of course different from those here since there was only one agreement in that case and it was entered into after the divorce, when the divorced wife threatened to take action against the husband because of his remarriage. But we call attention to the *Cox* case because, in holding against the husband there, the Third Circuit made it clear that, when, as in that case, an agreement is "independent and anchor-free of the divorce" (p. 230) and has been entered into to preserve a taxpayer's divorced status as to his former wife and his married status as to his second wife, it is not incident to the divorce although it may refer to such divorce. We submit that a somewhat similar situation existed here in that the second agreement was not a part of the "package of the divorce" but was independent of it and was entered into in order to enable the taxpayer's wife to acquire the status of a married woman after the dissolution of her first marriage by divorce. Consequently it is clear that the payments here were not in discharge of an obligation imposed by an agreement which was incident to the divorce.

**CONCLUSION**

The Tax Court's decision is correct and should be affirmed.

Respectfully submitted,

CHARLES K. RICE,

*Assistant Attorney General.*

HARRY BAUM,

LOUISE FOSTER,

*Attorneys,*

*Department of Justice,*

*Washington 25, D. C.*

MARCH, 1957.

## APPENDIX

Internal Revenue Code of 1939:

Sec. 22. GROSS INCOME.

\* \* \* \*

(k) [as added by Sec. 120(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Alimony, Etc., Income*.—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includable in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includable in the gross income of such husband. This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support. Installment payments discharging a part of an

obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered period payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if more than one such installment payment for such taxable year is received during such taxable year, the aggregate of such installment payments) does not exceed 10 per centum of such principal sum. For the purposes of the preceding sentence, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received. \* \* \*

\*       \*       \*       \*       \*

(26 U.S.C. 1952 ed., Sec. 22.)

### Sec. 23. DEDUCTIONS FROM GROSS INCOME.

\*       \*       \*       \*       \*

(u) [as added by Sec. 120(b) of the Revenue Act of 1942, *supra*] *Alimony, Etc., Payments.*—In the case of a husband described in section 22(k), amounts includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under section

22(k) or section 171, stated to be not includable in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection.

\* \* \* \* \*

(26 U.S.C. 1952 ed., Sec. 23.)

No. 15357

IN THE

United States Court of Appeals  
FOR THE NINTH CIRCUIT

---

HANS S. HOLLANDER and CLEMENCE BLUM HOLLANDER,  
*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

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PETITIONERS' REPLY BRIEF.

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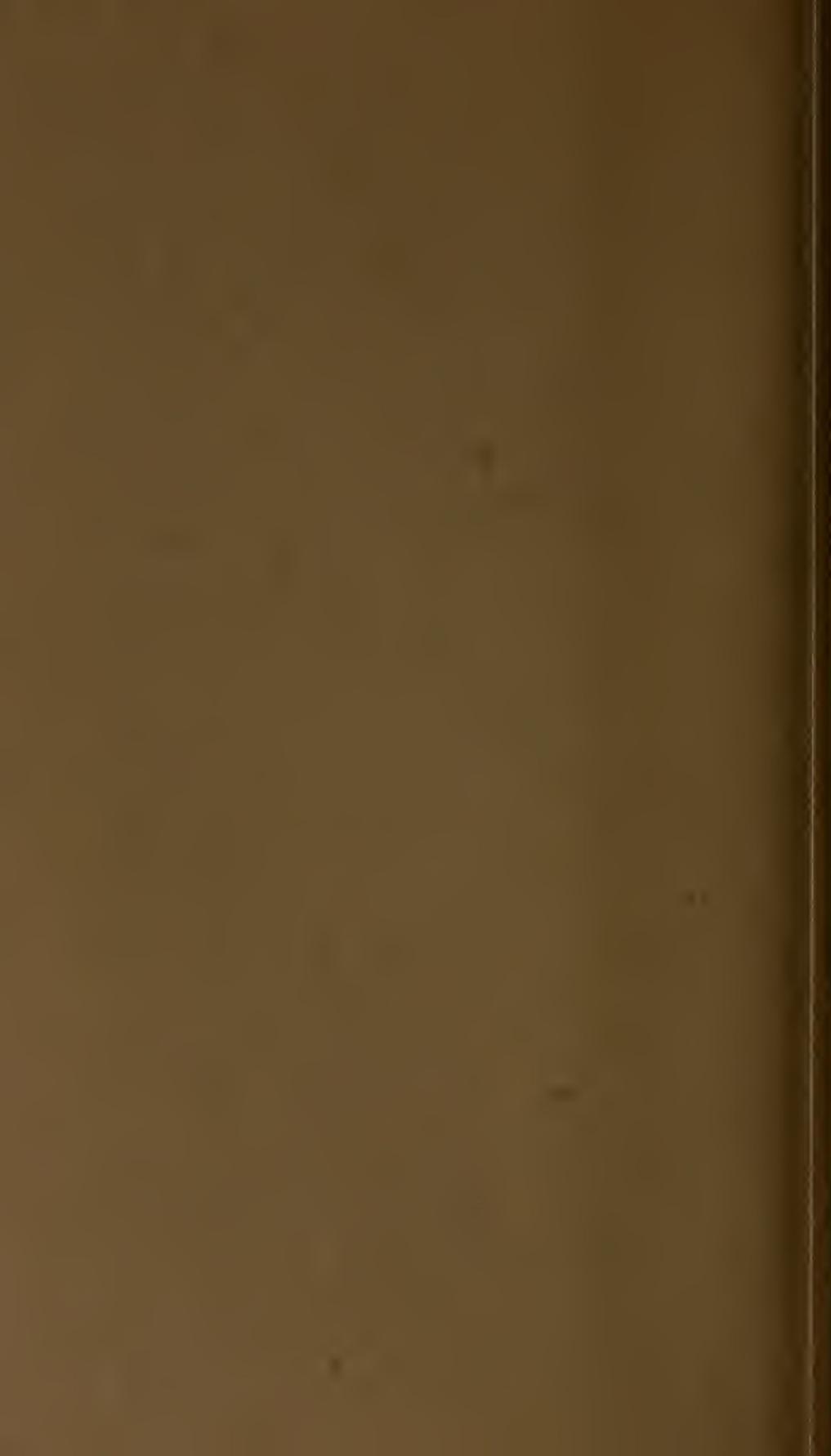
IRELL & MANELLA,  
LAWRENCE E. IRELL,  
LOUIS M. BROWN,  
EDWARD SANDERS,  
STANFORD G. ROSENBLUM,

6399 Wilshire Boulevard,  
Los Angeles 48, California,  
*Attorneys for Petitioners.*

FILE

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PAUL P. O'BRIEN, CL



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---

## PETITIONERS' REPLY BRIEF.

---

### Summary of Reply Brief.

This is a reply brief. We shall not attempt to repeat the arguments already set forth in our main brief. We deal only with the arguments advanced on behalf of the respondent, and with the specific matters in its brief which seem in most urgent need of correction.

The respondent in its brief has attempted to establish the non-deductibility of alimony payments made by Hans S. Hollander to his ex-wife Idy Hollander under the 1948 modifying agreement on what appears to be the following grounds: one, that the original agreement of 1946 was a "final" and unalterable settlement imposing a support obligation which could not be modified to provide for the revised support payments in question; and two, that the support obligation incurred under the 1948 modifying agreement was a new non-support obligation and a mere gratuity.

No case authority is presented in support of this position, just as none was cited in the Tax Court's opinion below. Moreover, respondent's position is mistaken because the reasons on which it is based are erroneous in law and fact. As a matter of state law, the support obligation imposed by the original agreement and decree of 1946 was at all times subject to valid modification, in the manner in which such modification was actually executed, despite the language of "finality" in the original agreement and decree. Inasmuch as the support obligation under the 1946 agreement and decree was validly modified, the support obligation under the 1948 agreement and decree was obviously not a new obligation but a continuance of the original obligation. In addition, as a matter of fact, the 1948 modifying agreement was bargained for and supported by traditional legal consideration in the form of mutual promises. (See Op. Br. 22-25.) It is fundamental law that where there is legal consideration for a promise, there cannot also be a gift or a mere gratuity.

Respondent in its brief has attempted to distinguish the instant case from *Newton v. Pedrick* and the other cases cited by petitioners (see Op. Br. 11) by limiting to the facts of the prior cases the rule of law developed therein. We submit, however, that the prior cases have developed a general principle of law consistent with legislative policy, namely: that were a legal obligation to support survives the dissolution of the marital relationship, subsequent adjustment of that obligation by later agreement or court order is incident to such divorce. This rule should be determinative of the instant case. As will be pointed out in this brief, respondent's attempt to limit this rule by emphasizing immaterial factual distinctions involves fallacious legal analysis inconsistent with legis-

I.

The Support Obligation Imposed By the Original 1946 Agreement and Decree Was Subject to a Valid Modification, in the Manner in Which Such Modification Was Actually Executed, Even Though Such Agreement and Decree Purported to Be a "Final" Settlement.

The respondent in its brief (Resp. Br. 11-13) and the Tax Court in its opinion [R. 59-62] assert that the original 1946 agreement and decree, at a time when they were in full force and effect, could not be validly modified to provide for reduced payments for a fixed period of years whether or not Idy remarried. The authority given for such assertion by both respondent and the Tax Court is the language of the 1946 agreement and decree which, concededly, declare themselves to be "final" settlements. These assertions by the respondent and the Tax Court, we submit, are based upon a total disregard of State law which recognizes as valid and judicially enforceable the modifications in question and upon an erroneous interpretation and construction of the language of "finality" contained in such original 1946 property settlement agreement and decree.

On June 30, 1948, the Superior Court of the State of California entered its decree establishing the 1946 Nevada decree as a foreign judgment, incorporating the 1948 modifying agreement, and ordering Hans S. Hollander to make the support payments in question.<sup>1</sup> [R. 17, 42-43.] It is submitted that the decree entered by the Superior Court of the State of California conclusively

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<sup>1</sup>Respondent totally without authority and documentation, goes so far in its Brief (Resp. Br. 12, fn. 3) as to assert that the Superior Court of the State of California was exceeding its authority by entering such decree.

demonstrates that the original 1946 agreement and decree were subject to a valid modification by mutual agreement despite their language of purported "finality." (See *Freuler v. Helvering*, 291 U. S. 35 (1934).) The law of the State of California allows court enforcement of revisions of purportedly "final" agreements where the parties have mutually agreed to the revision. (*Miller v. Superior Court*, 9 Cal. 2d 733, 72 P. 2d 868 (1937); Cal. Civ. Code, Sec. 139.) In such cases, the Court has the power to enter a decree incorporating the revised agreement to which both parties have agreed, even though the Court would not have jurisdiction to enter such a decree upon a unilateral petition of one of the parties. So, too, the law of the State of Nevada allows court enforcement of revisions by mutual agreement, even where there is language of "finality" which would prevent revision upon a unilateral petition.<sup>2</sup> (See Nevada Compiled Laws, Supp. 1943-1949, Secs. 9463, 25.)

The State law in this issue is based upon a well-grounded understanding of the purpose of putting "finality" language in a property settlement agreement and decree. Such language of "finality," like almost all legal concepts, is not to be read literally and out of context in the manner of the Tax Court and respondent, but is to be read in the light of the intent of the parties to the agreement and of the purpose to which the inclusion of the language was to serve. Language of "finality" in

---

<sup>2</sup>There is no conflict of laws issue present since the law of California and Nevada, the only states interested in the transaction, are exactly the same on this point.

a settlement agreement is used only to prevent harassment of one party by unilateral petition on the part of the other party to a court to upset the mutually agreed-upon arrangement of the parties. The inclusion of such "finality" clauses in agreements are commonplace since the purpose of having such a "finality" provision in an agreement is that its presence gives the parties certainty and predictability in their parting arrangements. One party cannot cause a change unless the other party agrees to it. It is fundamental, however, that parties to a contractual agreement can always modify their contract by another mutual agreement. Moreover, changing circumstances such as the economic position of the ex-husband or the economic needs of the parties, or their children, frequently dictate in the property settlement area that the parties renegotiate the terms of a purportedly "final" settlement. In such situations where there are changed circumstances, because of the inability of either party to revise the parting arrangements upon a unilateral petition to a court, it becomes very important from the standpoint of public policy to allow revision by mutual agreement. Yet the Tax Court and the respondent would not only deny that revision of continuing support obligations are justifiable from the standpoint of public policy, but they would go so far as to deny that such revisions are even legally possible. It is submitted that the Commissioner of Internal Revenue and the Tax Court are wrong as a matter of law and are incorrect as a matter of sound public policy.

II.

The Support Obligation Imposed by the 1948 Modifying Agreement and Decree Was Neither a New Obligation nor a Mere Gratuity.

The respondent in its brief (Resp. Br. 10-13) treats the 1948 modifying agreement as if it gave rise to a new non-support obligation of Hans S. Hollander which was unrelated to the support obligation arising from the original 1946 property settlement and agreement. Inasmuch as the support obligation under the 1946 agreement and decree was validly modified, the support obligation under the 1948 agreement and decree was obviously not a new obligation but a continuance of the original obligation.

Despite the fact that the 1948 support obligation was not a new obligation but a continuance of the original obligation, the respondent asserts that the support obligation imposed by the 1948 modifying agreement and decree was a mere gratuity following Idy's remarriage. (Resp. Br. 9, 16.) Therefore, the respondent must in effect be treating the facts as if Idy Hollander had remarried prior to the execution of the modifying agreement of 1948; if such were the case, then there could be no consideration for the support obligation under the 1948 modifying agreement because Hans S. Hollander, by such modifying agreement would then have been reviving an obligation of which he had been relieved or assuming an obligation which had never before been present. Even though the stipulated facts state precisely that Idy Hollander had not remarried on March 16, 1948 [R. 17], the respondent asserts it is "realistic" to consider Idy Hollander as being remarried on March 16, 1948. (Resp. Br. 16.) There is no evidence in the record which would

support a position by the Tax Court or the Government that Idy had *in reality* remarried on such date. In truth, the facts stipulate that the modifying agreement "enabled" Idy to remarry, which fact raises the inference that Idy would not have been able to remarry if she had been unable to secure such agreement. [R. 17.] As far as Hans S. Hollander was concerned, on March 16, 1948, he was under a fully enforceable legal obligation to support Idy Hollander for the rest of her natural life. The only way in which Hans S. Hollander could be relieved from his fully enforceable support obligation was by securing Idy's consent to relief or by an act (Idy's remarriage) over which Hans had no control and which was entirely within the discretion and whim of two independent parties, Idy and her prospective husband. Even though Hans knew Idy was strongly considering remarriage, it was a fact that on March 16, 1948, Idy Hollander had not only not remarried but might never have remarried for any number of reasons such as an accident to or change of heart by Idy or her prospective husband. Thus, the 1948 agreement was the result of a bargained for exchange of mutual promises which saw both parties suffering legal detriments as promisors and receiving legal benefits as promisees. (See Op. Br. 22-25.) Hans S. Hollander's promise to make payments whether or not Idy remarried was no act of mere generosity, such as it would have been had Idy Hollander remarried prior to March 16, 1948.

Hans S. Hollander did not assume any new non-support obligations because on March 16, 1948, he had been relieved of none of his support obligations under the original 1946 agreement and decree. If Hans S. Hollander can be said to have "voluntarily" assumed

any burdens by reason of the modifying agreement, such statement is meaningful only in the sense that any contractual relationship can be said to be "voluntarily" assumed; there is freedom to contract or not to contract and the execution of a contract is a volitional act. Indeed, every property settlement is a "voluntary" agreement of the parties. The respondent's assertion that a gratuity was involved is contrary to the facts and basic legal principles. The 1948 agreement and decree carried on without interruption the original support obligation imposed by the 1946 agreement and decree.

### III.

#### The Instant Case Falls Within a Clearly Established Rule of Law Which Properly Implements Legislative Intent.

As petitioner stated in its opening brief (Op. Br. 10-12), the rule of law applicable to this case is as follows: Where a legal obligation to support under an existing agreement incident to the divorce survives the dissolution of the marital relationship, subsequent adjustment of that obligation by later agreement or Court order is "incident to such divorce."

Although there are a substantial number of cases which have developed this rule (see Op. Br. 11), respondent would like to limit each one of those cases to its facts, and by so doing, limit the generality of the rule which the courts have developed. (See Resp. Br. 17-22.) As an example of respondent's technique of finding factual differences which are without legal significance, consider the leading case of *Newton v. Pedrick*, 212 F. 2d 357 (2nd Cir., 1954), reversing 115 Fed. Supp. 368 (S.D.N.Y., 1953). The original agreement in that case required the taxpayer to make payments to

his former wife of \$24,000 annually for life, or until her remarriage, and \$14,000 annually after her remarriage. At a time when the ex-wife had already remarried and thus the ex-husband's original obligation to make the larger payments of \$24,000 had terminated, the husband agreed to increase the ex-wife's payments by \$11,000 to \$25,000 annually in exchange only for the legal custody of the children of the marriage. The Court of Appeals for the Second Circuit allowed the deduction of the entire \$25,000, including the \$11,000 for which there was no obligation under the original agreement. Similarly, the fact that in the instant case the payments after remarriage were not provided for in the original agreement is immaterial. Moreover, in the instant case, because the ex-wife had not remarried, the modifying agreement *reduced* the husband's support obligation as well as securing for him the legal custody of his child. To state the comparison in another way, in the instant case the obligation to make the reduced payments after the wife's remarriage can be said to be a "new" non-support obligation only in the same sense that in *Newton v. Pedrick* the obligation to pay the extra \$11,000 annually after the wife's remarriage could be said to have been a "new" non-support obligation. "New" in point of time, yet related back to the original support obligation because it was a revision of such original support obligation. Although there are admittedly factual differences in the instant case from any previous case, it is submitted that these differences should be considered as without legal significance and the principle of law set forth above should be reaffirmed. The Commissioner of Internal Revenue has been unable to offer any authority or documentation for his position that certain types of support

payments under a bargained for modifying agreement are not deductible. The case of *Cox v. Commissioner*, 176 F. 2d 226 (3rd Cir., 1949), which the Commissioner suggests is similar (see Resp. Br. 22) is distinguishable because it is clearly a case of a gratuity where there was never at any time any enforceable support obligation which survived the dissolution of the marriage.

The merit of a rule that periodic alimony payments are deductible when made pursuant to a modifying agreement which resulted from a bargained for transaction is that such a rule permits taxpayers to adjust their surviving marital obligations in the light of changing circumstances. Sections 22(k) and 23(u) were relief measures added to the Internal Revenue Code to allow an equitable distribution of the tax burdens resulting from the adjustment of marital or family financial obligations in connection with the dissolution of the marriage relationship. Furthermore, as has been pointed out, in prior cases, there is nothing in the statute or its legislative background which suggests that such policy of affording relief was intended to be limited to those arrangements affected at the time of the decree of divorce or separation "without regard to possible future re-arrangements in consequence of later and perhaps *unforeseen* vicissitudes." (Italics supplied.) (See *Newton v. Pedrick*, 212 F. 2d 357 at 361.) The respondent would like to restrict the permissible modifications of an agreement to only those contingencies which the parties foresaw in the original agreement. It is submitted that such a limitation based on

foreseeability would undermine the entire rule permitting modifications; almost by definition, the parties, at the time of the original agreement, did not foresee the contingency which requires the modification, or else they could have taken care of the contingency in the original agreement and there would be no need to modify at all.

It is not without significance that the respondent in its brief did not answer petitioner's argument that the position of the Tax Court, if sustained, would result in freezing a great many taxpayers in their position under alimony arrangements, unless their situation was sufficiently pressing that they were willing to absorb the inequitable tax burdens from which Congress once tried to relieve them. The truth is that the Commissioner of Internal Revenue, by seizing upon incidental and irrelevant factual matters, would like to undercut the broad interpretation developed by the Courts of the statutory phrase "incident to such divorce." (See *Harold Holt v. Commissioner*, 216 F. 2d 757 (2nd Cir., 1955), reversing 23 T. C. 469, cert. den., 350 U. S. 982; compare *Commissioner v. Miller*, 199 F. 2d 957 (9th Cir., 1952), reversing 16 T. C. 1010; non-acq. 1951-2 Cum. Bull. 5.)

### Conclusion.

The payments made by petitioner, Hans S. Hollander, to his former wife, Idy, during 1948 and 1949 were deductible under Section 23(u) of the Internal Revenue Code of 1939 because such payments were in discharge of a legal obligation arising out of the marital or family

relationship, which obligation was imposed upon petitioner under a decree of divorce and under a written instrument incident to the divorce. The Commissioner of Internal Revenue's determination of a deficiency for those years should be disapproved, and the Tax Court's decision reversed, and judgment entered for the petitioner.

Respectfully submitted,

IRELL & MANELLA,

LAWRENCE E. IRELL,

LOUIS M. BROWN,

EDWARD SANDERS,

STANFORD G. ROSENBLUM,

*Attorneys for Petitioners.*

to the United States Court of Appeals  
for the Ninth Circuit

---

Glenn E. Johnson, Esq., respondent

v.

Federal Trade Commission, petitioner

\*

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In view of the nature of an appeal to take  
and decide,

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BRIEF FOR RESPONDENT

---

WILLIAM KURTNER

Counsel General,

JAMES A. CONNEY

Assistant Counsel General,

EDWARD H. CARTER, JR.,

ELIAS W. COOK,

Attorneys

Alameda, San Francisco, California.

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FILED

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U.S. COURT OF APPEALS



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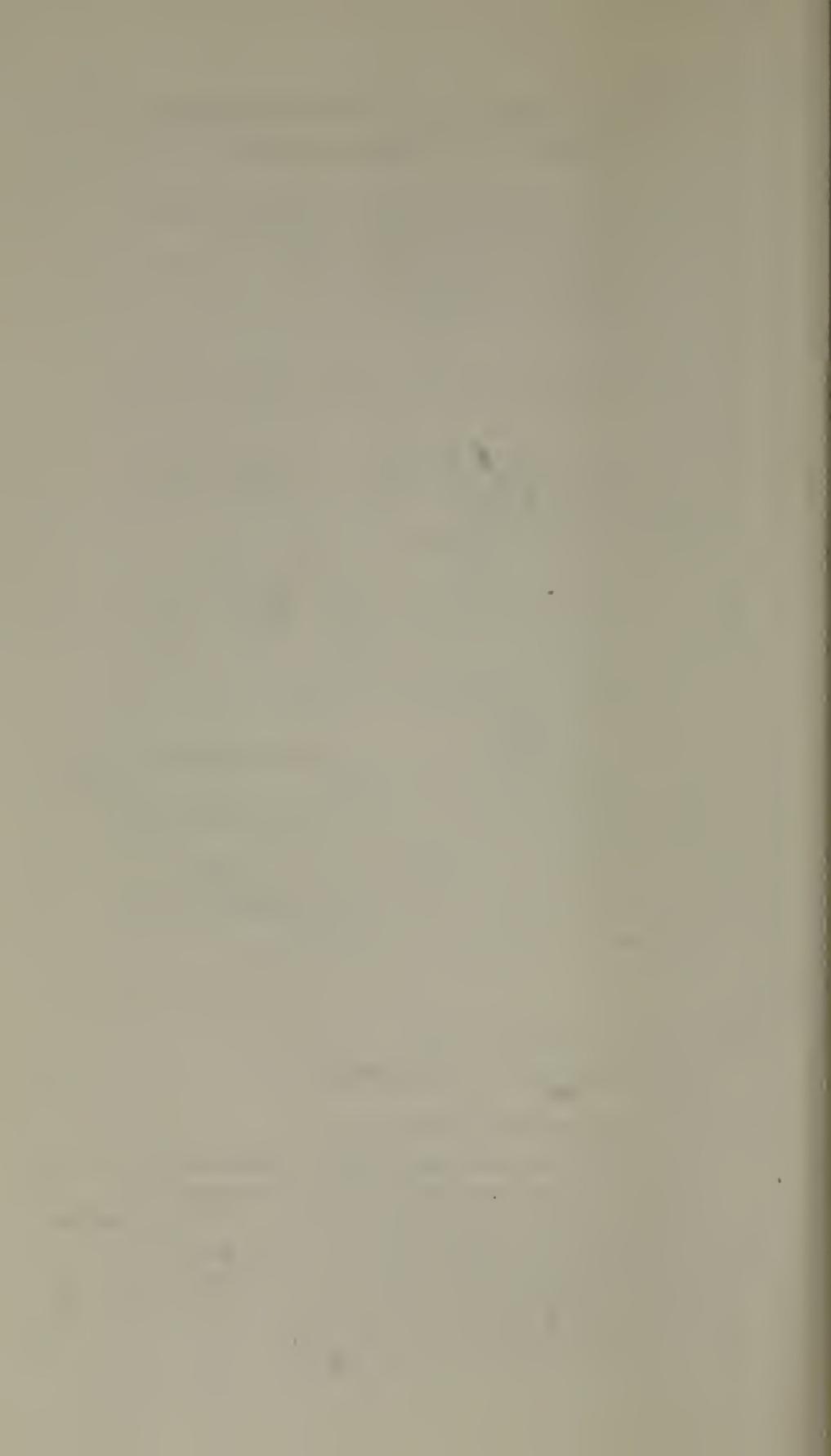
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In the United States Court of Appeals  
for the Ninth Circuit

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No. 15373

CARTER PRODUCTS, INC., PETITIONER

v.

FEDERAL TRADE COMMISSION, RESPONDENT

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*ON PETITION FOR THE REVIEW OF AN ORDER TO CEASE  
AND DESIST*

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BRIEF FOR RESPONDENT

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I

STATEMENT OF THE CASE

This case arises upon a petition for the review of and to set aside an order to cease and desist issued by the Federal Trade Commission at the conclusion of proceedings on a complaint charging petitioner with engaging in unfair and deceptive acts and practices in violation of the Federal Trade Commission Act.<sup>1</sup>

The Commission complaint alleged that Carter Products, Inc.<sup>2</sup> (Carter) was engaged in the sale and distribution in

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<sup>1</sup> The pertinent provisions of the Act are—

“Sec. 5(a)(1). . . . unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

“Sec. 5(a)(6). The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations . . . from using . . . unfair or deceptive acts or practices in commerce (66 Stat. 632, 15 U.S.C. 45(a)(1), 45(a)(6)).

<sup>2</sup> The complaint also named Street and Finney, a corporation engaged in the advertising business as respondent. The Commission dismissed the complaint as to this respondent.

commerce of a medicinal preparation known as "Carter's Little Liver Pills" (laxative pill), and had been making numerous false representations concerning this preparation which it sold throughout the United States. The complaint charged that such conduct constituted unfair and deceptive acts and practices in interstate commerce within the meaning of Section 5 of the Federal Trade Commission Act (R. 12940, Vol. I, 3-19).<sup>3</sup> Petitioner filed answer (id. at 21-29) in which it admitted its identity, the sale of the medicinal product and the dissemination of advertisements containing statements and representations as set forth in the complaint but the answer otherwise constituted a general denial.

After issue was joined, extended hearings were held before an examiner, beginning in November 1943 and ending in November 1945; 10,641 pages of testimony were taken and 2,209 exhibits were introduced. Upon the completion of the hearings, the examiner made his report to the Commission in July 1946 (R. 12940, Vol. I, 32-248), which contained a detailed and documented review of the evidence and the factual conclusions reached. Petitioner filed exceptions to this report (id. at 300) and the matter regularly came before the Commission for final disposition. The Commission considered the briefs filed and heard oral argument on the questions presented. Two Commissioners died and a third resigned before decision was reached and the case was reargued before the Commission after these vacancies had been filled. In March 1951 the Commission

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<sup>3</sup> This case was previously before the Court as No. 12940. It is now before the Court as No. 15373. The printed record in No. 12940 consisted of four volumes and these have been made a part of the present record. The additional parts of the record printed for this review, which consists of ten volumes, carry the case No. 15373.

Petitioner refers to the first four volumes using the citation O.R. and to the last ten under the designation N.R. We believe it more convenient to refer to the original printed record under the designation 12940 and the additional volumes under the designation 15373.

filed its findings of fact and conclusion (id. at 306) and issued a cease and desist order against this petitioner (Id. at 334).

Thereafter petitioner filed in this Court a petition for the review of the Commission's order (R. 12940, Vol. IV, 1681-1701) in which it did not then question the sufficiency of the evidence or the merits of the Commission's decision. The principal claim made was that petitioner had been denied a fair hearing in that the examiner had prejudicially restricted petitioner's cross examination of certain of the Commission's expert witnesses. This Court ruled (201 F.2d 446) that there had been "unjustifiable" restriction on cross examination of three such witnesses (Drs. Bollman, Lockwood and Case), and that the "cumulative" effect had operated to deprive petitioner of a fair hearing. The Court refused to consider whether there was other evidence ample to sustain the Commission's findings and orders so that the "unjustifiable" restrictions on cross examination were not actually prejudicial. The opinion concluded: "The order of the Commission is set aside."

The judgment entered by the Court provided that the Commission's order "be, and hereby is, set aside" (R. 15373, Vol. I, 25). A petition for rehearing alleged that error had been committed in failing to remand the case to the Commission to permit it to correct the errors which had been held to be prejudicial. The petition also alleged error in setting aside the order in its entirety, although the rulings which had been condemned did not affect in any respect numerous misrepresentations found by the Commission and severable parts of its order based thereon. This petition the Court denied without opinion (Id. at 26).

On petition for writ of certiorari the Supreme Court in a per curiam opinion (346 U. S. 327) granted the petition and at the same time vacated the judgment remanding the case with directions to this Court "to reinstate its prior judgment and order after amending it so that it specifically authorizes the Federal Trade Commission to open this

proceeding for further evidence and a new order consistent with the Court of Appeals' opinion herein." (R. 15373, Vol. I, 26-28).

Acting pursuant to the mandate of the Supreme Court this Court (on November 18, 1953) entered judgment in which it granted the petition to review and remanded the cause to the Commission with authorization "to open this proceeding for further evidence and a new order consistent with the opinion of this court" (R. 15373, Vol. I, 29-30). Thereafter the Commission entered an order reopening the proceeding and referred it to the hearing examiner "for such further proceedings as may be necessary to correct the errors in the original hearings as specified by the Court of Appeals" and ordered the examiner upon completion of the hearings to file with the Commission "a report upon the additional evidence and state the changes, if any, he wishes to make in his original recommended decision as a result of his consideration of such additional evidence." (Id. at 30).

Pursuant to this order, hearings were held at which Drs. Case and Bollman, two of the three expert witnesses, whose cross examination this Court held had been improperly curtailed and restricted, were tendered to petitioner for further cross examination.<sup>4</sup>

The cross examination of these witnesses was completed on April 30, 1954, and on June 25, 1954, petitioner filed a document containing motions and offers of proof (R. 15373, Vol. I, 33-56). One of these motions was to strike the testimony of Dr. John Salem Lockwood, which the examiner granted on February 9, 1955, and on March 3, 1955, entered an order closing the record for the reception of further evidence (Id. at 120-146).

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<sup>4</sup> Because of death, the third witness, Dr. Lockwood, whose cross-examination this Court held had been unduly restricted, could not be tendered for cross-examination. All of the testimony and all exhibits based upon or connected with the testimony of Dr. Lockwood were stricken by the examiner (R. 15373, Vol. I, 125).

On March 9, 1955, petitioner filed a notice of appeal from the order of the examiner closing the record and from his rulings denying petitioner's motions and offers of proof. Thereafter on March 28, 1955, petitioner filed a motion to disqualify the hearing examiner from taking any further action in this matter and for an order terminating these proceedings because of bias of the examiner. (R. 15373, Vol. I, 146-147).

On March 31, 1955, pursuant to the order of remand, the examiner filed his supplemental report and his recommendation as directed by the Commission (R. 15373, Vol. I, 173-199).

On September 20, 1955, the Commission entered an order denying petitioner's motion to disqualify the examiner and to terminate the proceedings (R. 15373, Vol. I, 245-256).

After obtaining from the Commission extensions of time for filing exceptions to the supplemental report of the examiner and its brief in support thereof, petitioner on November 30, 1955, filed its exception to the examiner's original and supplemental reports (R. 15373, Vol. II, 257-264; Vol. IX, 3557).

Thereafter the matter was heard by the Commission on briefs and oral argument. The Commission made its findings as to the facts (R. 15373, Vol. I, 267-310), and concluded (id. at 310) that the acts and practices of petitioners as found constituted unfair and deceptive acts and practices in violation of the Federal Trade Commission Act and issued its order to cease and desist (Id. at 311).

Petitioner thereafter timely filed its petition for review (R. 15373, Vol. VIII, 3531-3539) and its statement of points relied upon (id. at 3540), alleging numerous errors as having been committed by the Commission.

#### THE FACTS

We are here concerned with a simple laxative preparation and numerous representations made in connection with it. The record is large and voluminous, but it is important to notice that the actual area of factual conflict relates simply

and solely to what influence, if any, petitioner's laxative pill will have on the production and flow of bile. There are many facts in this case not involving this subject which are not in dispute. We shall summarize the facts with appropriate record citations and appropriate notation of the area of controversy.

Carter Products, Inc. is a Maryland corporation with its office and principal place of business located in New York. It has for many years been engaged in the sale and distribution in commerce of a medical preparation known as "Carter's Little Liver Pills" (R. 15373, Vol. I, 267-268).

The Commission found (R. 15373, Vol. I, 271-272) and it is not disputed that the quantitative formula for this medicinal preparation is:

Podophyllum Resin U.S.P. 1/16 gr.  
Po. Purified Aloes 1/4 gr.

The Commission also found (R. 15373, Vol. I, 272) on undisputed evidence that: "Podophyllum Resin, also known as podophyllum, is used as a laxative or drastic cathartic, and aloes is one of the irritant cathartics ranking with senna, rhubarb and cascara sagrada." This preparation, serves to increase temporarily the motility of the large bowel by irritation and thus induces partial evacuation of the large intestine (Id. 272).

The Commission found (R. 15373, Vol. I, 269-271) and it is not disputed that petitioner in connection with the sale of this laxative preparation had represented that it (1) represents a fundamental principle of nature in self-treatment; (2) is a competent and effective treatment for "a sluggish liver"; (3) will "wake up the flow of bile," is "effective in making bile flow freely"; (4) will cause the proper flow of gastric juices, vital digestive juices and vital alkaline juices; (5) is based on the fundamental principle of the operation of the digestive system, will "help food digestion," "lessen food decay," regulate digestion and the digestive system; (6) restore regularity, is a cure and

remedy and constitutes a competent and effective treatment for constipation; (7) will clear away the "dark clouds of listlessness and despondency" and "give one's personality a chance"; (8) will "keep up one's pep and vigor," "make one feel good and up to par again" and "keep one smiling and happy"; (9) will eliminate bad disposition and keep good dispositions "cheerful, happy and a regular thing"; (10) will help in more ways than one to make one feel better again fast and differently and will provide two-way relief; (11) follows nature's own order for regularity and so regulates the digestive process that if taken at night one will awaken feeling the way one wants to feel, "full of normal old-time pep and vigor," "alive," "alert," "cheerful," "peppy," "eager," "robust," "bright," "lively," "full of pep," "bounce," "energy," "springy," "snap," "go and vigor," "spry and chipper again," "perked up," "up on your toes," "up to snuff," "up to par again," "fit as a fiddle," "chipper-as-a-chipmunk," "on-top-of-the-world," "up and up," "rarin'-to-go," ready to "jump out" or "roll out" of bed, "singing like a lark," "singing a song for the sheer joy of living," "fresh as a daisy," "glad to be alive," "ready for a big breakfast"; (12) will influence the flow of liver bile so that one can overeat and overindulge without any discomfort and if one has overeaten or overindulged it will overcome such discomforts and enable one to wake up, "roll out of bed," "rosy and bright," "clear eyed and steady-nerved," "feeling just wonderful," "feeling like a million," free from that "blue-Monday feeling," "ready for a great big breakfast," "alert and ready for work"; (13) does not contain any strong medicine and is safe to use; (14) is a competent and effective treatment for some 70 mental and physical disorders set forth in Paragraph Seven of the complaint (R. 12940, Vol. I, 8-9); (15) will have therapeutic value in the treatment of disorders and diseases of the liver.

Upon consideration of the record the Commission found that the representations as summarized above and found to

have been made were misleading in material respects. It also found that through the use of the word "Liver" in the name "Carter's Little Liver Pills" petitioner had falsely represented that this preparation would have some therapeutic action, effect and influence on the liver, and is for use in the treatment of conditions, disorders, and diseases of the liver.

The Commission's finding as to the false and deceptive character of the representations made was based on its further findings that: "Inasmuch as the laxation afforded by an irritant laxative or cathartic is not a normal physiological method of evacuation and is not based on any principle having relation to natural bowel motility, it is not true that the preparation represents a fundamental principle of nature in self-treatment." (R. 15373, Vol. I, 272) This finding in turn was based on the evidence of the several doctors who testified: Dr. Ivy (R. 12940. Vol. II, 547); petitioner's witness, Dr. Lopez (id 896); petitioner's witness, Dr. Avrack (id 897); petitioner's witness, Dr. Whittemore (id 899); petitioner's witness, Dr. Leader (id Vol. III, 931); petitioner's witness, Dr. Dorman (id 932); petitioner's witness, Dr. Sanford (id 933, 934); petitioner's witness, Dr. Boyd (Id. 936).

The Commission also found (R. 15373. Vol. I, 272-273) that "In a scientific sense, constipation is a term used to connote a slower rate of evacuation of the large bowel than the one normal for that individual. Although it has reference to delay in the passage of indigestible residues through the alimentary tract and to infrequency of bowel action, and may be used to describe the condition in which the stools are dry and hard, constipation has been described also as being that condition which causes a person to believe that a cathartic is necessary to cause a bowel movement. Normal frequency in bowel movement varies widely among individuals. Because varied notions obtain with respect to what represents normal frequency, the average layman may not diagnose constipation properly and there

is a tendency for self-diagnosis to be made on the basis of symptoms having no relationship to constipation.

"In its chronic form, there are two general types of constipation: (1) spastic, and (2) atonic. The state of the musculature of the large bowel differs in the two conditions named. In the spastic variety, the musculature is abnormally contracted and rigid and does not propel the contents thereof forward in a normal manner. In the atonic condition, usually associated with an enlargement of the large bowel due to tremendously increased content, the musculature does not contract and retain its tonus or state of partial contraction. Atonic constipation is attributable to constitutional weakness of the muscles of the colon and is supposed to occur principally in the rectum, while the spastic type is supposed to be due principally to anxiety, worry, or nervous strain. Among the causes of constipation or irregularity of bowel movement are improper diet and stool habits, insufficient intake of fluids and variations or obstructions of the alimentary tract such as fissure, cancer and debilitating conditions. Factors predisposing to chronic constipation are numerous and thorough study by the physician is necessary before comprehensive treatment is undertaken. Its treatment, therefore, varies in individual cases, but is directed to correcting the basic conditions which are responsible." The several doctors who testified were in entire agreement on these fundamental propositions. (Dr. Carlson R. 15373; Vol. I, 399; Dr. Ivy R. 12940. Vol. II, 542-546; Dr. Palmer, id 692-693).

The Commission further found that with respect to the type of constipation known as spastic, petitioner's laxative pills "will tend to aggravate any state of spasticity which is present" (R. 15373. Vol. I, 274; see also R. 12940. Vol. I, 547). The Commission concluded therefore that any representation that the pills are a cure or remedy for and constitute a competent and effective treatment for constipation are false and misleading.

In this connection, the Commission further found (R.

15373; Vol. I, 274) on undisputed evidence that the habitual use of irritant laxatives and cathartics tends to produce irregularity rather than to restore regularity in cases of chronic constipation and the use of petitioner's preparation will not restore regularity of bowel movement (R. 12940; Vol. I, 287; R. 15373; Vol. II, 650; R. 12940; Vol. II, 695).

The Commission also found (R. 15373; Vol. I, 274) and it is not disputed, that the statements appearing in the advertising to the effect that petitioner's product is composed of two vegetable medicines and the references to "gentle action purportedly afforded by its use" (id 274); see also id. Vol. II, 648) imply that petitioner's laxative pills do not contain strong medicines.

The Commission found (R. 15373, Vol. I, 274) and the record shows, however, that petitioner's laxative pills do contain strong medicines. The Commission pointed out, and the record shows, that though the ingredients of these pills are obtained by purifications of members of the plant kingdom they are in fact irritant purgatives. The record shows that aloes taken in sufficient amounts lead to some hyperemia and increased vascularity. Neither aloes nor podophyllin is absorbed to any great extent and as long as they remain in the colon may cause local irritation.

The Commission also found and it is not disputed that the product is not safe for and harmless to all individuals who are constipated or suffering delay or irregularity of bowel movement and symptoms thereof or from failure of digestion. It was found and it is not disputed that the pills are potentially injurious if taken by persons suffering from abdominal pains, nausea, vomiting, or other symptoms of appendicitis (R. 15373; Vol. I, 274-275). It was found and it is not disputed that it may cause perforation of the intestine in instances where delay in the evacuation is due to obstruction in the tract. It was pointed out (id 275) that in some instances the use of these pills may be attended with griping and stomach discomfort and when used in the presence of constipation of the spastic type

may serve to increase and aggravate such state of spasticity (id 275). It found and the evidence is uncontradicted that the use of a laxative is contraindicated in many conditions.

The Commission also found (R.15373; Vol. I, 304-305) that the ingredients in this laxative neither alone nor in combination will have any therapeutic action, effect, or influence, corrective or otherwise, on the liver. The preparation will have no therapeutic value in the treatment of any condition, disorder, or disease of the liver or the biliary system. This finding was based on undisputed evidence of Doctors Carlson (R. 12940. Vol. I, 366), Ivy (id. Vol. II, 549) and Palmer (id 689-690.) Upon consideration of the remedy which should be applied under the circumstances the Commission was of the opinion (R.15373; Vol. I, 308) that only excision of the word "Liver" from the product name would serve to eliminate the deception engendered by its use.

The Commission also found (R. 15373, Vol. I, 303, 304) that these laxative pills will not increase the production and flow of bile. The present controversy centers in this area of the findings. The Commission witnesses, Doctors Carlson (R. 12940; Vol. I, 255-258, 376, 386), Palmer (id 284) and Ivy, (id. 267-270) uniformly testified that this laxative would have no effect on bile flow. Petitioner's witnesses included Doctors Hazelton, Morrison and Killian. Doctor Morrison testified on direct examination that this laxative would effect bile flow (R. 15373; Vol. III, 1071); Doctor Hazelton said his experiments would not permit a conclusion (R. 15373; Vol. II, 795) and Doctor Killian said that it would effect bile flow under conditions and his statement of those conditions essentially and practically negates the conclusion.

As to any possible effect the petitioner's laxative pill may have on the formation or flow of bile, the Commission in its findings considered the testimony and other evidence relating to experiments conducted by various scientists, offered in support of the complaint (R. 15373; Vol. I, 277-286), and of those offered by the petitioner (id 286-291); in addi-

tion, the Commission in its findings considered and weighed the challenges and criticisms made by petitioner of the various experiments performed by the scientists offered in support of the allegations of the complaint (id 292-299) as well as the criticisms and challenges made by counsel supporting the complaint as to the experiments performed by scientists offered on behalf of the petitioner. (id 299-302) The Commission in its findings also considered and weighed the expressions of scientific view by witnesses presented by the petitioner as to the effect "that a favorable influence on bile flow may result from the increased intestinal motility afforded by the irritating action of a laxative" of the same type as that of the petitioner (Id 302).

Then after all such considerations, the Commission found that "the greater weight of the testimony and other evidence introduced into the record supports informed determinations," that petitioner's laxative pills "will not stimulate the formation of bile by the liver or increase the secretion of bile by the liver"; the Commission further found that petitioner's laxative pill will not increase the flow of bile or any constituents thereof into the duodenum (Id. 303-304).

#### CONTESTED ISSUES

In its brief (6-10) petitioner lists twelve specifications of alleged errors and summary of argument. In specifications 1 through 8, petitioner states that the findings are erroneous because of the alleged method and manner in which the Commission considered or failed to consider the testimony and other evidence relating to experiments and tests conducted by witnesses for the Commission and for petitioner. This evidence was admitted into the record as being responsive to the allegations in the complaint that petitioner's statement as to the effect of its laxative pill on bile was false and misleading. The findings referred to in petitioner's specifications must, therefore, relate to the

Commission's findings that petitioner's laxative pill will have no effect on the formation or flow of bile. That this is true is borne out by petitioner's argument in its brief. Petitioner develops its argument under three points. Under Points I and III, petitioner contends that there is no substantial evidence to support the findings of the Commission that its laxative pill will have no effect upon the formation or flow of bile. This is only one of the many findings of fact made by the Commission relating to the falsity of petitioner's statement as to the therapeutic value of its laxative pill. Point II is based upon petitioner's contention that it was denied a fair and impartial hearing.

We therefore believe that the only issues raised before this Court are:

1. Whether the findings that petitioner's laxative pill will have no effect on the formation or flow of bile is supported by the greater weight of the evidence?, and
2. Whether petitioner was denied a fair and impartial hearing?

### III

#### ARGUMENT

##### Preliminary Statement

(1) In view of the voluminous record and the lengthy briefs we believe it is important that attention be focused on the actual area of controversy. It must be appreciated that in the proceedings before the Commission there was at issue the truth or falsity of numerous representations concerning the therapeutic value of this pill admittedly sold only as a laxative and admittedly containing only two active drugs—aloes and podophyllum—both recognized as irritative laxatives.

While there appears to have been a general charge made in the petition for review that the findings were not supported by substantial evidence, examination of petitioner's

brief discloses that the actual area of attack is very limited. As we understand petitioner's contentions they relate only to those findings regarding the flow of bile. This court cannot be "compelled to search the record for undesignated error" claimed upon an omnibus assertion that the findings are unwarranted. *North Whittier Heights Citrus Ass'n v. National Labor Relations Board*, 109 F.2d 76, 83 (C.A. 9, 1940), cert. denied 310 U.S. 632 (1940). The rules<sup>5</sup> of this Court and established precedents demonstrate that it is only the particular findings attacked which are to be considered by the Court on review. See, *Dayton Rubber Mfg. Co. of Delaware v. Sabra, et al.*, 63 F. 2d 866 (C.A. 9, 1933); *Mutual Life Ins. Co. of New York v. Wells Fargo Bank & Trust Co.*, 86 F.2d 585, 587 (C.A. 9, 1936); *Smith v. Hopkins*, 120 F. 921, 923 (C.A. 7, 1902).

Under the circumstances, therefore, we submit that regardless of what this Court's decision may be on this particular issue of fact raised by petitioner, NEVERTHELESS, the Commission is entitled to and the Court should enter a decree (1) affirming all other findings of fact, and (2) enforcing Subsections (a), (b), (c), (d), (e), that portion of (f) which reads: ". . . or to prevent or overcome discom-forts caused by overindulgence in food or other pleasures," (g), (h), (i), (j), (k), (l), (m), (n), (o) of Paragraph (1) and Paragraph (2) of the order to cease and desist.

(2) In considering the vigorous and sustained attack made by petitioner on the Commission's expert witnesses we believe it is important to invite the Court's attention to the many basic facts which are not really the subject of any dispute and which necessarily must be considered in evaluating the numerous claims made by the petitioner. Thus

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<sup>5</sup> Subsection 2(d) of Rule 18 of the Rules of this Court, among other things, provides: ". . . In all cases, when findings are specified as error, the specification shall state as particularly as may be wherein the findings of fact and conclusions of law are alleged to be erroneous."

it appears that petitioner's own expert witnesses<sup>6</sup> testified that laxatives, such as petitioner's laxative pill, are prescribed solely for the temporary relief afforded by the evacuation of the bowels.

Petitioner's pill is a laxative. The qualitative and quantitative formula is Podophyllum Resin USP 1/15 Gr., PO Purified Aloes, 1/4 Gr. (CXs. 4-B, 5-B). Aloes is classified as one of the irritant laxatives and podophyllum is a drastic cathartic (R. 12940, Vol. II, 552). Podophyllum has been removed from the U. S. Pharmacopeia (id. Vol. IV, 1337-1338). These two drugs are "vegetable drugs" as they are obtained from some member of the plant kingdom. They are not vegetables in the sense that they can be eaten (id. Vol. II, 556, 684). The two drugs contained in petitioner's laxative pill have no different action when taken separately. (R. 15373, Vol. I, 359-360; Vol. II, 685; Vol. IV, 1572); and they have no synergistic effect. (R. 15373, Vol. II, 503-504; R. 12940, Vol. II, 884; Vol. IV, 1572-1573; R. 15373, Vol. I, 427-429).

Bile is partly a secretion and partly an excretion of the liver. A normal liver which is not diseased will produce the amount of bile normally required for the proper function of the digestive system (R. 15373, Vol. I, 407-408; R. 12940, Vol. II, 530). The function of bile in the human digestive system is the emulsification of fat in the food and the absorption of such fat and fat soluble vitamins (R. 15373, Vol. I, 368-369, 371-372; Vol. II, 478-479, 475-476). The chief characteristics of bile are bile acids, bile pigments, fatty acids and cholesterol. The basic ingredients of bile are bile salts or bile acids (id. Vol. I, at 371-373; Vol. VII, 2918; R. 12940, Vol. II, 532). The facilitating of the

<sup>6</sup> Drs. Harry Julius Johnson, Abbott W. Allen, Joseph Jordan Eller, Walter Ralph Loewe, Rafael Ernesto Lopez, James S. Edlin, John Albert Averack, W. Laurance Whittemore, Frederick Steigmann, Leonard Owen Leader, Duane D. Daling, Henry P. Dorman, William C. Colbert, Louis F. Boyd (R. 12940, Vol. II, 879-883, 896-898, 899-901; Vol. III, 929-936, R. 15373, Vol. II, 831; Vol. III, 942-946).

digestion and absorption of fat is the sole function of bile. It has no effect upon the digestion of proteins (R. 15373, Vol. I, 372, 375). If there is an impairment or a disease of the liver which cuts the production of bile to 80% there still would remain sufficient bile for the proper digestion of fat food (R. 12940, Vol. IV, 1417-1418, 1478). An individual does not require the production of two pints of bile daily to prevent digestive disturbances (Id. Vol. II, 671-674, 1557).

We believe it is equally important to invite the Court's attention to the fact that there is no evidence of any nature in the record that any doctor has ever prescribed petitioner's laxative pill for any purpose other than to produce an evacuation of the bowels.

There is no evidence of any nature in the record that this laxative pill of petitioner *when taken as directed* will have any effect upon the formation secretion or flow of bile. And there is no evidence of any nature in the record that this laxative pill of petitioner *when taken as directed* will have any effect upon any disease or disorder of the liver:

(3) Petitioner suggests (Pet. Br. 151-152) that since this proceeding started many years ago there is no present need for an order to cease and desist. But we invite the Court's attention to the fact that there is no evidence or in fact any statement which would show that petitioner has discontinued the advertising statements found to be false and misleading and which furnish the basis for the order to cease and desist. Certainly petitioner cannot by a mere unsupported "suggestion" make any valid claim as to discontinuance. *Marlene's Inc. v. Federal Trade Commission*, 216 F. 2d 556 (C. A. 7, 1954). In fact its whole position in this regard is suspect since it is still contesting the validity of the Commission's order. . But despite that, there is simply no evidence in this regard that the testimony, experiments and other evidence upon which the Commission based its findings is not presently valid, up to date, and applicable.

(4) Consideration of petitioner's brief convinces us that

it is replete with inaccuracies and misconceptions of the record. In our opinion petitioner's brief presents a distorted version of the testimony and experiments of the expert witnesses who testified in the proceeding. We are convinced that petitioner's brief contains many misstatements of fact and that it would be impossible to prepare a detailed reply to each and every misstatement and therefore we shall undertake to point out certain of the distortions and misstatements which we consider illustrative of the type set forth in the brief filed by petitioner. For example: On page 15 of its brief, petitioner emphasizes, and quotes out of context, portions of two statements made by Dr. Ivy and applies these statements to the fistula dog experiments performed by Dr. Ivy. Petitioner then contends that prior to Dr. Ivy's retention by the Commission to perform these tests and "when he had . . . no motive or bias to subserve," Dr. Ivy admitted that an inherent vice existed in this type of experiment because "the physical conditions are entirely changed" and there is produced thereby "a disturbance and possible creation of abnormal difference in pressure."

In an effort to bolster and clothe this contention with a semblance of truth, petitioner reaches into the testimony of Dr. Carlson, and states that his testimony supplied "the common sense reason for this basic fallacy in such test methods . . ."; that Dr. Carlson (1) "swore . . . that if the bile does not flow into the intestines in the normal way, this has both a 'back' and a 'bad' effect upon the liver," and (2) "that all the various units of the biliary system must be operating normally in order for the experiments to be valid." Petitioner here flatly tells this Court that when Dr. Carlson so testified he was specifically referring to the fistula test methods as performed by Dr. Ivy.

An examination of this testimony of Dr. Ivy and Dr. Carlson will show, however, that petitioner has diverted this testimony from its true and intended meaning and misapplied it to the experiments performed by Dr. Ivy in

an effort to show that the fistula method experiments were basically unsound, worthless and of no scientific value<sup>7</sup> so as to destroy the impact of the results obtained by Dr. Ivy upon petitioner's claims as to the therapeutic value of its laxative pills.

When Dr. Ivy was being cross examined (R. 15373, Vol. II, 683-684), counsel asked him if he thought that the manner in which he had prepared the dogs for his experiments "produced any physiological or pathological changes of any kind in the animals." Dr. Ivy asked counsel, "What do you mean abnormal or pathological cases [sic]? What do you refer to?" Counsel then read the following statement—which appeared in an article that Dr. Ivy had previously identified (R. 12940, Vol. II, 708) as having been written by him entitled "Physiology of the Gall Bladder," published in "Physiology Reviews" in 1934—

But with a duodenal tube in place or with a duodenal or common duct fistula, the physical conditions are entirely changed, a fact that has been disregarded too frequently.

and asked Dr. Ivy, "What do you mean by that statement?" Dr. Ivy replied that he would "have to see the context." After reading the article Dr. Ivy said:

Now, the sentence that the attorney just read is a sentence in a discussion of the question "Is the force of contraction of the gall bladder sufficient to force bile into and through the cystic duct?" "Intrinsic ability of the gall bladder to evacuate." And under a separate head, "Intra-abdominal pressure."

And that sentence simply indicates that when there is a duodenal tube in the duodenum, it means that the

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<sup>7</sup> The record establishes the fact and it is not contradicted by any testimony of any witness that the biliary fistula method experiments as performed by Dr. Ivy are accepted and officially recognized as a proper method to be used in laboratory experiments on the formation and flow of bile. See ante p. 32.

duodenal pressure communicates with the atmospheric pressure on the outside of the abdomen and that is all that statement refers to. If you don't have a tube down the duodenum, under ordinary conditions, the pressure in the duodenum does not reflect the pressure on the outside.

Counsel then asked Dr. Ivy, "Well what about your reference to the 'common duct fistula?'" To which Dr. Ivy replied:

The same thing is true. The pressure on the outside opens into the common duct. The situation is the same—just a disturbance and of possible creation of abnormal difference in pressure.

(R. 15373, Vol. II, 683-685). Dr. Ivy was explaining that the sentence referred to by counsel simply indicated that when a duodenal tube was inserted in the duodenum the normal pressure of the duodenum was affected by the atmospheric pressure, resulting in a change, a difference of pressure in the duodenum. This testimony has nothing whatever to do with the correctness of the methods used by Dr. Ivy in his fistula dog experiments and it is not a pronouncement or a flat concession that there was an inherent vice in the experiments performed by him on the fistula dogs. There is no language in that testimony from which a normal, logical inference can be drawn that the fistula dog experiments contain "fatal infirmities" as petitioner would have this Court believe.

Now let us examine the testimony of Dr. Carlson, which petitioner refers to as supplying the common sense reason for the alleged basic fallacy in Dr. Ivy's tests. Dr. Carlson was being questioned as to his experiments with the digestive and hepatic systems (R. 15373, Vol. I, 343-345), and was asked what experiments he had made on the hepatic system, Dr. Carlson replied:

I have studied the machinery of the emptying of the gall bladder, and I have made some studies of the back effect on the liver by obstruction of the bile passage, so that the bile secreted cannot flow into the intestines.

When Dr. Carlson was asked to explain what he meant by the statement "back effect on the liver," he replied:

What I mean by that is this, that the liver itself may be perfectly normal. Then you get a stone in the common duct, or you may get catarrah. You may get it filled with mucus or you may get cancer obstructing the duct. Then that secretion of bile extends the duct. *It does not get into the intestine in the normal way*, and that has a bad effect in the way of injuring the liver. (Emphasis supplied)

Here Dr. Carlson was testifying to conditions which completely obstruct the normal flow of bile from the liver, which resulted in the bile backing up into the bile duct of the liver thus causing injury to the liver. This testimony of Dr. Carlson had nothing whatever to do with the fistula dog experiments conducted by Dr. Ivy as petitioner would suggest. Petitioner should know that in the fistula dog experiments there was no obstruction of the flow of bile at any time in either the duodenal tube draining or the T-tube drainage method; that the bile flowed freely from the common duct of the liver into the tubes and outside into a bag or a cylinder and there collected. And yet, petitioner flatly tells this Court that this testimony of Dr. Carlson in reference to the obstruction of the common duct of the liver by cancer, stone, catarrah and mucus, preventing completely any flow of bile, applies squarely to the tests performed by Dr. Ivy. We respectfully submit that petitioner here is being something less than candid with this Court.

In addition, petitioner, referring to the testimony of

Dr. Carlson (R. 12940, Vol. II, 481-482), states that Dr. Carlson swore "that all the various units of the biliary system must be operating normally in order for the experiments to be valid." There is no such statement made by Dr. Carlson in the testimony referred to. After Dr. Carlson had testified (1) as to the effect upon the digestive system of a decrease of fifty per cent in the normal flow of bile, (2) that an individual normally has more bile than needed, (3) that there are certain diseases of, and injuries to, the liver that decreases the production of bile, (4) that obstructive disturbances of the duct and bladder and sphincter system causing the retention of bile, Dr. Carlson was asked, "In other words, the various parts or units of the biliary system, such as the liver, the gall bladder, the ducts, and the sphincter must all operate normally, or the machine is thrown out of gear is that about right?" Dr. Carlson replied: "That would be a fair statement, but in degree. The machine is thrown out of gear even if we have twenty-five per cent reduction in the production of bile from the liver, but that doesn't necessarily mean that the machinery of digestion of fat is thrown off, because we don't need all the bile, normal bile for the digestion of fat."

It is apparent from the above that Dr. Carlson was not referring in any way to the fistula dog experiments conducted by Dr. Ivy; and that his testimony as to the biliary system operating normally in no way relates to the validity or invalidity of the experiments conducted by Dr. Ivy.

In addition to the above questionable statements appearing on this one page of petitioner's brief (p. 15), petitioner also attempts to discredit the testimony of Dr. Ivy. Petitioner tells the Court that the statement of Dr. Ivy "of the inherent vice in his animal tests . . . was made . . . before his retention by the Commission to perform these experiments in this case and at a time when he had accordingly no motive or bias to subserve." Petitioner is here telling the Court that Dr. Ivy was retained by the Com-

mission to perform these experiments. This statement is made out of the whole cloth. There is not one vestige of truth in it.

Petitioner throughout its brief (i.e., pp. 69, 78) improperly claims that Dr. Ivy had written an article to the effect that there is a causal relationship between constipation and bile flow. When questioned about that particular article by petitioner's counsel, Dr. Ivy said that he had "found that distention of the entire colon was associated with an inhibition of bile flow in 12 out of 14 dogs." He reminded counsel, "that was acute distention. It lasted only for a period of 5 or 10 minutes" (R. 12940, Vol. II, 707). Dr. Ivy also said: ". . . Acute distention does not have a marked inhibitory effect on the formation of bile, so that you can easily counteract it, in other words, by giving some sodium dehydrochloate" (id. at 709). Dr. Ivy explained that human beings with a "cathartic colon" have a condition "which would be analogous to the type of condition we were trying to produce in the dog and monkey" (id. at 712; id. Vol. IV, 1567). When Dr. Ivy was asked if there was any connection in the creation or flow of bile and constipation, he said "No, there is none . . ." (id. Vol. II, 541).

In its brief (p. 69) petitioner makes a further attempt to make a false impression as to Dr. Ivy's views concerning constipation and bile flow. Dr. Ivy testified that a complete lack of bile "would be called a predisposing factor" in constipation. When asked if constipation did result "would the constipation be likely to increase the tendency toward lack of bile?", Dr. Ivy replied: "No" (R. 12940, Vol. II, 714). Dr. Ivy went on to say that his article entitled "The Rationale on Bile Salts Therapy" was to the same effect (id. at 715).

Petitioner also attempts to cite the duodenal drainages that Dr. Ivy performed on "constipated" human beings and jejunal fistula dogs as evidence that Dr. Ivy regards the duodenal drainage method as proper to test the

efficacy of petitioner's laxative pills. Dr. Ivy explained that although he did not think the duodenal drainage method was reliable, he used it in his experiments for the purpose of completing his series of studies. He said: "For quantitative work, the duodenal or the method of duodenal drainage is very unreliable . . ." He continued and said, "We have obtained no evidence to show that [petitioner's laxative pills] promote the flow of bile into the duodenum," (R. 12940, Vol. IV, 1538-1539).

Perhaps one of the worst examples of distortion indulged in by petitioner in its brief appears on page 150 in which it states that Dr. Bollman testified, ". . . one would have to devise better tests than we have now in order to ascribe a significant difference to minor changes in the correlation of the flow of bile." Petitioner quotes only a part of a sentence in Dr. Bollman's testimony. What Dr. Bollman actually said was: "One would have to devise better tests than we have now in order to ascribe a significant difference in minor changes in the correlation of the flow of bile *with the condition of the liver as judged by hystologic examination or in comparison with other tests*" (R. 12940, Vol. IV, 1496). Petitioner omitted the italicized portion of Dr. Bollman's testimony. Dr. Bollman was testifying on whether anesthetics would diminish the bile flow and as to the correlation of the flow of bile with the condition of the liver following the giving of an anesthetic. He testified that in the light of present knowledge the diminution of bile flow following the giving of an anesthetic would not be of any significance. He explained this by saying, "I would expect the effect of ether to cause diminution in the rate of bile flow during the time of ether anesthesia and perhaps continuing, perhaps 2 or 3 hours after recovery from the ether—at the end of that time the animals would revert to normal and the bile flow would be the same as normal" (R. 15373, Vol. VIII, 3456). The experiments of Dr. Bollman on the dogs (CXs 195-A, B and C) required from 7 to 35 days for their completion and

the fact that perhaps for 2 or 3 hours after the ether was administered there might have been diminution of bile flow could not have any influence on the results of the experiments for the reason that the dogs' livers after the 2 or 3 hours had thrown off the effect of the anesthesia and were functioning normally. Petitioner's statement (Br. 150) that Dr. Bollman had testified as to "the inadequacy and lack of significant sensitivity" of the "liver function tests" used by him in his dog experiments is without foundation and a complete distortion of Dr. Bollman's testimony.

This brings us now to a consideration of the evidence in this record upon which the Commission based its finding that petitioner's laxative pill will have no effect on bile.

### **1. The Finding That Petitioner's Laxative Pill Will Not Increase the Flow of Bile Is Supported by the Greater Weight of the Substantial Evidence.**

The applicable law in this case is well settled. Except as to the issue of a fair and impartial hearing, the sole issue of fact developed by petitioner and properly before this Court relates to the effect of petitioner's laxative pill on bile. The Commission is the trier of the facts. And its finding here that this laxative pill will have no effect on bile is a finding of fact which is conclusive and binding on this Court if supported by substantial evidence. The statute so provides.<sup>8</sup> This Court has often so held.<sup>9</sup> Whether a witness possesses the requisite qualification as an expert and whether tests were properly conducted are also questions of fact to be determined by the Commission,

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<sup>8</sup> Federal Trade Commission Act, § 5(c); 52 Stat. 113; 15 U.S.C. 45(c); *Federal Trade Commission v. Standard Education Society, et al.*, 302 U.S. 112, 117 (1937).

<sup>9</sup> *Jacques De Gorter and Suze C. De Gorter, etc. v. Federal Trade Commission*, 244 F. 2d 270 (C.A. 9, 1957); *Philip R. Park, Inc. v. Federal Trade Commission*, 136 F. 2d 428, 429 (C.A. 9, 1943); *American Medicinal Products, Inc. v. Federal Trade Commission*, 136 F. 2d 426 (C.A. 9, 1943).

and such determination is conclusive unless palpably wrong, *Leach v. Carlile*, 258 U. S. 138, 139-140 (1922).

Opinion evidence based on the general medical and pharmacological knowledge of qualified experts constitutes substantial evidence, even if the experts have no personal experience with the product, *Goodwin v. United States*, 2 F. 2d 200, 201 (C. A. 6, 1924); *Dr. W. B. Caldwell Inc. v. Federal Trade Commission*, 111 F. 2d 889, 891 (C. A. 7, 1940); and this is true even where witnesses who had personally observed the effects of the product testified to the contrary, *John J. Fulton Co. v. Federal Trade Commission*, 130 F. 2d 85, 86 (C. A. 9, 1942); *Bristol-Myers Co. v. Federal Trade Commission*, 185 F. 2d 58, 62 (C. A. 4, 1950); *Justin Haynes & Co. v. Federal Trade Commission*, 105 F. 2d 988, 989 (C. A. 2, 1939); *Neff v. Federal Trade Commission*, 117 F. 2d 495, 497 (C. A. 4, 1941); *J. E. Todd, Inc. v. Federal Trade Commission*, 145 F. 2d 858 (C. A. D. C., 1944).

It is too well settled to require argument that it is for the Commission and not the Courts to pass upon the credibility of witnesses and the weight to be accorded their testimony, and this Court has so held, *Tractor Training Service, et al. v. Federal Trade Commission*, 227 F. 2d 420, 424 (C. A. 9, 1955). Also see *Corn Products Refining Co., et al. v. Federal Trade Commission*, 324 U. S. 726 (1945); *Federal Trade Commission v. Standard Education Society, et al.*, 302 U. S. 112, 117 (1937); *Standard Distributors, Inc., et al. v. Federal Trade Commission*, 211 F. 2d 7, 12 (C. A. 2, 1954); *P. Lorillard Co. v. Federal Trade Commission*, 186 F. 2d 52, 57 (C. A. 4, 1950).

It is well settled that the "weight to be given to the facts and circumstances admitted as well as inferences reasonably to be drawn" therefrom are for the Commission, *Federal Trade Commission v. Pacific States Paper Trade Assn.*, 273 U. S. 52, 63 (1927), and the "possibility of drawing either of two inconsistent inferences from the evidence" does not prevent the Commission from draw-

ing one of them, *National Labor Relations Board v. Nevada Consolidated Copper Corp.*, 316 U. S. 105, 106 (1942).

It is also well settled that courts of appeals must not "pick and choose bits of evidence to make findings of fact contrary to the findings of the Commission," *Federal Trade Commission v. Standard Education Society, et al.*, 302 U. S. 112, 117 (1937). Inferences of fact drawn by administrative agencies "may not be set aside upon judicial review because the courts would have drawn a different inference," *National Labor Relations Board v. Southern Bell Telephone Co.*, 319 U. S. 50, 60 (1943); *National Labor Relations Board v. Nevada Consolidated Copper Corp.*, 316 U. S. 105, 106-107 (1942).

In reviewing the decision of administrative agencies, the courts are to "consider the whole record." But "the requirement for canvassing 'the whole record' in order to ascertain substantiality" was not "intended to negative the functions of . . . those agencies presumably equipped or informed by experience to deal with the specialized field of knowledge whose findings within their field carry the authority of an expertness which courts do not possess and therefore must respect. Nor does it mean that even as to matters not requiring expertise a court may displace [an agency's] choice between two fairly conflicting views, even though the court would justifiably have made a different choice had the matter been before it de novo." *Universal Camera Corp. v. National Labor Relations Board*, 340 U. S. 474, 487-488 (1951).

The Supreme Court has also declared that the Commission was created with the avowed purpose of resting the administrative functions committed to it in a body of experts specially competent to deal with them, *Humphrey's Executor v. United States*, 295 U. S. 602, 621, 625 (1935). It is "not the province of the court to absorb the administrative functions to such an extent that the executive or legislative agencies become mere fact finding bodies." *Gray v. Powell*, 314 U.S. 402, 412 (1941).

In a proceeding of this nature the power of this Court is not administrative but judicial and "the range of issues open to review is narrow. Only the questions affecting the Constitutional power, statutory authority and the basic prerequisites of proof can be raised. If these legal tests are satisfied, the Commission's order becomes incontestable," and "judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the Administrative body." *Dobson v. Commissioner of Internal Revenue*, 320 U. S. 489, 501 (1943).

The above applicable principles of law have neither been limited nor restricted by the Administrative Procedure Act. The Administrative Procedure Act (60 Stat. 243-244, 5 U. S. C. 1009(e)) provides that administrative agencies should make their findings on the whole record "taking into account contradictory evidence or evidence from which conflicting inferences could be drawn." This Court speaking through District Judge Yankwich in the De Gorter case, 244 F. 2d 270, 272-273 (C. A. 9, 1957), had this to say:

The enactment of the Administrative Procedure Act has placed upon the Courts the responsibility of reviewing the entire record with the object of determining whether, on the whole, substantial evidence sustained the action of the administrative body. This means that

"... the findings are to be accepted unless they are unsupported by substantial evidence on the record considered as whole."

So doing, Courts will not substitute their judgment for that of the Commission. As stated by the Court of Appeals for the Second Circuit recently,

"It was for it, not for us, to pass upon the credibility of the witnesses and the weight to be given their testimony in the light of it; conflicting or other-

wise . . . having done so, the findings of the Commission, when, as here, the record as a whole gives them substantial support, are final *even though the evidence is so conflicting that it might have supported the contrary had such findings been made.*"<sup>10</sup>

Bearing those well settled and applicable principles of law in mind, we now turn to the record and examine the evidence upon which the Commission based its findings that petitioner's laxative pill will not increase bile flow.

**a. Petitioner's Laxative Pill Will Have No Effect Upon the Formation or Flow of Bile**

The complaint alleged (Par. Nine; Vol. I, 11-15) that petitioner's laxative pill "will not wake up the flow of bile . . . is not effective in making bile flow freely . . . will not influence the production or flow of liver bile . . . will have no therapeutic action, effect or influence on the secretion or flow of bile . . ."

The Commission found (Par. Fourteen, R. 15373, Vol. I, 303-304) ". . . that the greater weight of the testimony and other evidence introduced into the record supports informed determinations that [petitioner's laxative pill] will not stimulate the formation of bile by the liver or increase the secretion of bile by the liver. Inasmuch as the evidence further shows that [petitioner's] product will not cause the gall bladder to contract or cause laxation of the sphincter of Oddi or prevent its contraction in the first instance or serve in any way to milk bile from the ampula of Vater or the bile duct, the Commission further concludes that [petitioner's laxative pill] will not increase the flow of bile or any constituents thereof into the duodenum."

Petitioner attacks this finding on the ground that the evidence relied upon is insubstantial because the witnesses whose testimony the Commission relied upon, were

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<sup>10</sup> See also *Tractor Training Service v. Federal Trade Commission*, 227 F. 2d 420, 424-425 (C.A. 9, 1955).

biased and prejudiced and because the experiments upon which the Commission relied were defective and not properly conducted. Petitioner's entire argument in support of its contention relates to the credibility of the witnesses and the weight to be accorded their testimony and the legality of the experiments in connection therewith.

This Court has often held that it is for the Commission and not the courts to pass upon the credibility of witnesses and the weight to be accorded their testimony (see *supra*, p. 25). Whether the experiments relied upon by the Commission were properly conducted or legal is a question of fact and like all questions of fact is to be determined by the Commission and such determination is conclusive unless palpably wrong (see *supra*, pp. 24-25).

The finding of the Commission here is based upon opinion evidence expressed by expert witnesses which is undenied and uncontradicted, and upon the results of tests and experiments conducted by experts.

Dr. Andrew J. Carlson, one of the greatest physiologists in the world, testified that petitioner's laxative pill will have "no effect whatever on secretion and the flow of bile in health or in diseases" (R. 12940, Vol. I, 386).

Dr. Walter L. Palmer, a member of the faculty of the University of Chicago Medical School, testified that the concensus of competent, informed medical opinion was that the drugs, aloes and podophyllum, constituents of petitioner's laxative pill, will not increase the production or flow of bile (R. 12940, Vol. II, 696-697).

Dr. Andrew C. Ivy, Head of the Division of Physiology, Pharmacology, Materia Medica and Toxicology of Northwestern University; Director of the Naval Medical Research Institute of Bethesda, Maryland, testified that in his opinion petitioner's laxative pill will have no effect on the formation and flow of bile or bile salts (R. 12940, Vol. II, 533).

In addition to this uncontradicted opinion testimony, the record contains experiments made by scientists in an

effort to find what effect petitioner's laxative pill would have upon the formation and flow of bile. These experiments were performed by Dr. Ivy, Dr. Bollman and Dr. Case.

i. Experiments Performed by Dr. Ivy to Determine if Petitioner's Laxative Pill Will Have Any Effect Upon the Formation of Bile by the Liver

For the purpose of determining whether or not the drugs contained in petitioner's laxative pill (aloes and podophyllum) would have any effect upon the formation of bile by the liver, Dr. Ivy performed certain experiments on dogs (see CX 97). The dogs were given ether, their gall bladders removed and a catheter inserted in their cystic ducts, their common bile ducts cut so that all of the bile formed by the liver flowed out through the catheter into a bag or cylinder from which it was removed, measured and analyzed. This type of experiment is known as biliary fistula.

We might note here petitioner's attempt (Br. p. 14) to lead the Court to believe that the anesthetics used on the dogs would abolish or exempt the flow of bile while the experiments were being conducted. This is not a fact. Dr. Ivy testified (R. 12940, Vol. II, 716) that none of these dogs were used until the effect of the ether had worn out and their livers were functioning normally. Dr. Herman Annegers, one of petitioner's witnesses, who assisted Dr. Ivy in these experiments, stated that no dog was used until they were certain that the dog was normal and putting out a constant volume of bile (R. 12940, Vol. II, 910-911).

Eleven experiments (CX 97; R. 12940, Vol. II, 575-579) were performed on 5 dogs thus prepared. A controlled period of 2 or 3 days was run on the dogs during which time the dogs were fed a weighed amount of standard diet. The bile was collected, measured and analyzed at the end of each 24 hours. After the control period a test period of 2 or 3 days was run, during which time the animals were fed the same standard diet but in addition were given a capsule containing a mixture of aloes and podophyllum

in an amount equivalent to that found in 3 of petitioner's laxative pills. The bile was collected, measured and analyzed every 24 hours. The bile collected during the controlled period and the bile collected during the test period were compared.

For the purpose of comparing the effect on the secretion of bile where bile salts only were given, and where bile salts plus a mixture of aloes and podophyllum equivalent to that found in 2½ petitioner's laxative pills is given, 8 additional experiments were performed on 2 dogs (CX 97, p. 2). With the dogs prepared in the same manner as in the first experiment, controlled tests were run for 2 or 3 days, during which time the dogs were fed the regular diet only, the bile collected and analyzed every 24 hours. Then a test period of 2 or 3 days was run. The dogs were fed the regular diet daily with 3 grams of bile salts added, the bile collected and analyzed every 24 hours. Then for another 3 days the dogs were fed the regular diet daily with 3 grams of bile salts plus the aloes and podophyllum mixture, the bile collected and analyzed every 24 hours (CX 97, p. 3, Table II; R. 12940, Vol. II, 596-597). Dr. Ivy testified that the addition of the aloes and podophyllum mixture to the diet ". . . had no significant effect. You see the addition of the bile salts caused an increase in bile salt output. When we added to the bile salts the aloes-podophyllum mixture, no further increase occurred" (Id. at 599).

Dr. Ivy explained that the bile salts were added to the diet because "there was a possibility that bile salts might increase the action and absorption of the active ingredients of podophyllum and aloes . . . and then, too, we are simulating normal conditions associated with the normal flow of bile into the intestines." Dr. Ivy explained that bile "normally flows into our intestines, and in the experiment in Table I (CX 97) there was no bile in the intestine, there was no bile salt there. You see, the bile salts are the active ingredients of bile, insofar as digestion is concerned" (R. 12940, Vol. II, 591).

In order to determine what would happen when the same experiment is repeated a number of times on the same animal, Dr. Ivy made 7 tests on 1 dog. During the controlled period the dog was given a meal with no bile salts for 3 days, during which time the bile was collected, measured and analyzed. The dog was next given the same meal except 3 grams of bile salts were added for 3 days and the bile collected, measured and analyzed. Then the dog was given a meal containing 3 grams of bile salts and in addition thereto an aloes and podophyllum mixture equivalent to 3 of petitioner's laxative pills for 3 days and the bile collected, measured and analyzed (CX 97, p. 4, Table III; R. 12940, Vol. II, 595, 596). Dr. Ivy testified that the result of these experiments ". . . shows that the addition of the aloes-podophyllum mixture to the bile salts had no effect on the output of the bile or the choleic acid content of the bile" (Id. at 603).

Dr. Carlson testified that he was familiar with the method employed in the tests made by Dr. Ivy; that he had read them and studied them. When asked if they were accepted and recognized as proper methods to be used in the scientific tests of this nature, he said: "They certainly are" (R. 12940, Vol. I, 384). Dr. Ivy also testified that the methods used by him are accepted and officially recognized in the field of laboratory experiments as being the proper methods to determine the formation and flow of bile (Id. Vol. II at 577).

Dr. Herman Annegers, one of petitioner's witnesses, who assisted Dr. Ivy in the experiments, stated that no dog was used until they were certain that the dog was normal and putting out a constant volume of bile (R. 12940, Vol. II, 910-911). Dr. Annegers further stated that the results of the tests made by Dr. Ivy showed that petitioner's pill had no effect on the formation or flow of bile (Id. at 910, 919-921).

Dr. Ivy stated that the results of his experiments on the animals was transferrable to man; that "there is nothing known which stimulates the flow of bile in a dog

that does not stimulate the flow of bile in a human being. . . ." He stated that the functional activities of the liver of the dog and of the human being "vary significantly in one respect, and that is as to the metabolism or [sic] uric acid," that "the human being excretes uric acid in the urine and the dog oxidizes it to allantoin." (R. 12940, Vol. II, 622, 624; Vol. IV, 1513). See also the testimony of petitioner's witness, Dr. Crandall, to the same effect (R. 15373, Vol. VII, 2914), and the testimony of Dr. Bollman (R. 12940, Vol. IV, 1478).

Dr. Lloyd W. Hazelton, a witness for petitioner stated that his experiments on dogs and other animals were for the purpose of making the results available to the clinicians (R. 15373, Vol. II, 823).

**b. There Is No Relationship Between Constipation and the Secretion or Flow of Bile**

Dr. Ivy testified that there is no relationship between constipation and bile flow. He said "you can divert the bile from the intestines of dogs and human beings without getting constipation" (R. 12940, Vol. II, 541).

Dr. Bollman stated that he did not think that constipation would bring about a condition which would cause the flow of bile to be so small that the process of digestion and absorption would be affected (R. 12940, Vol. IV, 1414). He stated that "the concensus of modern, informed medical opinion is that there is no relationship between constipation and the secretion of bile by the liver (R. 12940, Vol. IV, 1497).

He stated that the absence of bile from the intestine would result in the fat being contained in the fecal matter and "give rise . . . to soft bulky stools and diahrrea" (R. 12940, Vol. IV, 1415).

Dr. Crandall, petitioner's witness, testified that he did not think constipation under any circumstances decreased the flow of bile to such an extent as to affect the digestive process. He said that he knew of no evidence to this effect (R. 12940, Vol. IV, 1672).

In addition to the above opinions expressed by these expert witnesses that there is no relationship between constipation and the flow of bile, the record contains experiments in relation to this subject conducted by Dr. Ivy and Dr. Bollman.

i. Experiments Conducted by Dr. Ivy to Determine if Constipation Affects the Flow of Bile

Dr. Ivy performed certain experiments on dogs and human beings. Dr. Ivy testified that he was interested "in seeing if we simulated a condition of constipation in the human being," whether petitioner's laxative pill "would promote the formation of bile" (R. 12940, Vol. II, 609-617; Vol. IV, 1518-1536). Dr. Ivy testified that he ran a controlled test period for 2 or 3 days, in which the dogs were fed daily their usual standard diet, their bile collected, measured and analyzed. He then ran a test period for 2 or 3 days in which the dogs were daily fed their standard diet to which had been added bone meal and the bile collected, measured and analyzed. He said that thereafter petitioner's laxative pills were administered to these dogs; one animal 14 pills were given in 2 days; another animal 20 pills were given in 3 days; and the third animal 20 pills were given in 2 days, until "we obtained a cathartic effect from the pills", at which time "we stopped the test," (id. Vol. II, 216). He stated that by this effect he meant "a mushy stool." Dr. Ivy further testified that when catharsis was obtained, the animals were not upset. He testified that the bile was collected, measured and analyzed. He stated that the results of these experiments were that "constipation per se did not change, or did not reflexly decrease the output of bile, and the pills did not significantly increase the output of the bile, and the catharsis did not significantly increase the output of bile, that is, on the average" (R. 12940, Vol. II, 618).

In his experiments on human beings who claimed to be constipated, Dr. Ivy stated that after the subjects had fasted 12 to 15 hours, a duodenal tube was passed into the

stomach and the gastric contents evacuated and then the tube was passed into the duodenum and the duodenal drainage was collected for 1 hour. At the end of the hour a warm sodium chloride solution was introduced through the tube into the duodenum, the drainage tube clamped off for 5 minutes, and then the drainage was collected for the remainder of the second hour. At the end of the second hour, four of petitioner's laxative pills which had been ground and suspended in a warm saline solution, were injected into the duodenum, and the tube washed out with a warm saline solution. The drainage was collected every hour for 4 hours after the injection of the solution of laxative pills.

During the next week these subjects were given 4 of petitioner's laxative pills before retiring and were to continue this dose each night until extensive laxation or cramping occurred, in which event they were to cut the dose to 2 laxative pills. At the end of the week, the second series of these experiments were conducted under identical conditions as those that pertained to the first series (R. 12940, Vol. IV, 1521-1526).

Dr. Ivy testified that "because of the variable nature of our own duodenal drainage" he "would not risk [his scientific reputation] and conclude on the basis of this data" that the taking of petitioner's laxative pill for 1 week "caused sufficient irritation of the colon to bring about reflex contraction of the sphincter" (R. 12940, Vol. IV, 1532). He stated that although the data was "in places statistically significant," he would not state the petitioner's laxative pill "increases the flow of bile into the duodenum." He said that if he concluded "from the data" that it did, then he also had to conclude that the "administration of petitioner's laxative pill for a week caused a spasm of the sphincter of oddi which decreased the flow of bile into the duodenum to a figure less than it was before they took" petitioner's laxative pills (id. at 1533).

This conclusion of Dr. Ivy coincides with the opinion expressed by petitioner's principal witness, Dr. Killian, who stated that on the basis of his experiments he could not make the general statement that petitioner's laxative pills taken for the relief of constipation until the stools averaged 100 grams a day and normal movement is restored, resulted in an increase in the flow of bile into the duodenum (R. 12940, Vol. III, 1234-1236).

ii. Experiments Conducted by Dr. Bollman to Determine if Constipation Affects the Flow of Bile <sup>11</sup>

Before discussing the experiments of Dr. Bollman, we think it necessary to answer some of the unwarranted attacks made by petitioner upon this outstanding scientist.

Dr. Bollman had consistently testified in the original hearings that there is no causal relationship between constipation and the flow of bile. At a hearing on remand petitioner's counsel read an article to the effect that there is a causal relationship between constipation and bile and asked Dr. Bollman if he agreed with it. Dr. Bollman stated that he did. When Dr. Bollman on redirect examination was asked how he reconciled that answer that he agreed with the article to his testimony that there is no causal relationship between constipation and the flow of bile, he replied that he could not reconcile such an answer. He said he had made a mistake in stating that he agreed with the article, and wanted ". . . to change that answer . . ." Dr. Bollman was only stating that he had made a mistake and wanted to correct it. The matter is that simple (R. 15373, Vol. VIII, 3415-3416).

<sup>11</sup> Petitioner criticizes Dr. Bollman for not using more than 3 dogs. Dr. Bollman stated the reason for this was because ". . . the findings on these 3 dogs were essentially the same and quite conclusive to my mind" (R. 12940, Vol. IV, 1413). He went on to say that he had arrived at the same conclusion years ago in performing similar experiments and that literature contained matters corresponding with his findings and for this reason he saw "no particular point in repeating the same thing" (id. at 1413).

On page 73 of its brief, petitioner again attempts to convince the Court that Dr. Bollman in one of his published articles has stated that there was a causal relationship between constipation and bile flow. Petitioner's counsel read a statement appearing in an article, of which Dr. Bollman was co-author, and he asked Dr. Bollman: "If that statement is correct, it is possible, is it not, that there is a connection between some function of the liver and the physiological processes which cause constipation?" Dr. Bollman replied: "One would have to say that it is possible, yes." (R. 15373, Vol. VIII, 3259). But he went on to say, however, in this same connection, ". . . I know of no direct connection, no cases where a direct connection has been shown." He said: "I cannot recall ever having heard of anything that would substantiate a relation in that regard" (Id. at 3423).

Petitioner tells the Court (Br. 73-79) that certain excerpts from articles by well-known scientists on the causal relationship between constipation and bile flow were read to Dr. Bollman and that he agreed with the statements therein made. Petitioner contends that in agreeing to these statements, Dr. Bollman contradicted his own testimony. There is no foundation for this. In those instances in which Dr. Bollman agreed with a specific statement made in an article, Dr. Bollman explained that while it was true, ailments of the gall bladder and other parts of the gastro-intestinal tract frequently occurred along with constipation, there was no "causal" relationship between such ailments and bile flow (R. 15373, Vol. VIII, 3394, 3415-3417).

Petitioner criticizes Dr. Bollman in reference to his statements made as to the method used in preparing Commission's Exhibit 202, and again claims Dr. Bollman was caught in an untruth.

The evidence (R. 15373, Vol. VIII, 3356-3366), we believe, will establish the following facts: Dr. Bollman prepared Commission's Exhibit 202 to determine the physiological

significance of the data of Dr. Morrison's experiments. He said that in preparing Respondent's Exhibits 349, 350 and 351, to determine the physiological significance of the data applicable to each of these exhibits, he used the same method he used in preparing Commission's Exhibit 202. Respondent's Exhibits 349, 350 and 351 were prepared for publication. Commission's Exhibit 202 was not prepared for publication. Dr. Bollman stated when exhibits are being prepared for publication in medical journals, the publishers prefer statistical treatment of the data. He submitted the data of Respondent's Exhibits 349, 350 and 351 to a statistician for determination of the statistical significance of the data relating to these exhibits. He himself did not make the statistical determination. It appears, therefore, that when Dr. Bollman stated that he had used the same method in preparing Respondent's Exhibits 349, 350 and 351, he was referring to the method employed by him to determine the physiological significance and not the method employed by the statistician. In this respect Dr. Bollman was telling the truth.

It is true that Dr. Bollman testified that at times undue absorption of water was associated with constipation (R. 15373, Vol. VIII, 3240). He stated, however, that this was not always true either in dogs or man in that fecal matter might be retained in the colon for such a period of time as to irritate the colon and thus cause secretion of water, so that the feces contained more water than normal (Id. at 3411).

Dr. Bollman testified that the fecal matter found in the colons of the three dogs, used by him in his experiments, corresponded to what they would have been during constipation (R. 15373, Vol. VIII, 3241). He stated if the fecal matter had been present in the colons of human beings as long as it was in the colons of the dogs, "the composition of the fecal material would be essentially similar" to what it was in the dogs' colons (Id. at 3408).

To summarize Dr. Bollman's position on the subject of

the relationship of constipation and bile flow, he testified that insufficient bile flow would bring about "a fat soap stool which is soft because of the failure of fat digestion . . ." and "diarrhea frequently accompanies" such a stool (R. 15373, Vol. VIII, 3415).

Dr. Bollman performed experiments on 3 dogs for the purpose of ascertaining whether intestinal obstruction affected the secretion of bile by the liver.<sup>12</sup> He sectioned the terminal end of the colon near the beginning of the rectum. Then invaginating in the same manner as is done in an appendectomy, with both ends of the sections being treated in the same way (CXs 199B, 200C, 201B; R. 15373, Vol. VI, 2469). By this surgery complete intestinal obstruction was obtained—so that there was no possibility of any material passing further down the colon (R. 12940, Vol. IV, 1387-1388, 1399; R. 15373, Vol. VI, 2469, 2611).<sup>13</sup>

With the dogs thus completely obstipated, they were fed 150 grams of meat and 100 grams of Karo syrup daily (R. 12940, Vol. IV, 1388).<sup>14</sup> Dr. Bollman testified that the dogs ate the diet daily, which indicated that they were in good condition, that their digestion was going on; that

<sup>12</sup> See CXs 195A, 195B, 195C, 196, 197A, 197B, 198A-B, 199A-E, and 200G.

<sup>13</sup> In its brief, petitioner indicates that this type of experiment was out of the ordinary. However, Dr. Crandall, one of petitioner's witnesses stated that he had performed the same type experiments on dogs in which he had accomplished "a complete obstruction of the colon" which corresponds to the condition of the dogs that Dr. Bollman operated on. (R. 15373, Vol. VII, 2909).

<sup>14</sup> Petitioner contends (Br. pp. 102-103) that this diet was an exceedingly high carbohydrate diet and protects the liver from injury and that because of this the results of Dr. Bollman's experiments were worthless. Dr. Bollman testified that this was not in his opinion a high carbohydrate meal (R. 15373, Vol. VIII, 3334). He stated that he did not give that diet to protect the livers of the dogs. He said: "Had I been attempting to make the liver more resistant I would have given much less meat and much more carbohydrate." Dr. Bollman stated that he selected this diet because he thought it was best suited for these experiments and explained the reasons (R. 12940, Vol. IV, 1389-1390, 1494-1495).

their liver was functioning adequately. He stated that in experimental conditions where the liver has been damaged or the biliary duct occluded, the dogs will not eat normally (R. 12940, Vol. IV, 1391, 1394, 1400, 1407). Dr. Bollman further stated that an autopsy on these dogs showed that all of the food was completely digested and that all that was left in the colon was the residue (R. 12940, Vol. IV, 1411-1412). He said that the autopsy also disclosed that the colons of these dogs were distended because the feces could not escape. He stated that this distention, however, did not in any way affect the ability of the livers of these dogs to produce bile (R. 12940, Vol. IV, 1413).<sup>15</sup>

Dr. Bollman further testified that the duodena of these animals were not distended (R. 12940, Vol. IV, 1452-1454).

To determine whether the livers of the dogs continued to function properly and without any damage up to the time of their death, Dr. Bollman used two recognized liver function tests: bromsulfoldin test and bilirubin retention test.<sup>16</sup> Dr. Bollman stated that in the bromsulfoldin test 76.5 milligrams of bromsulfoldin in a salt solution was injected intravenously. He stated this injection was made for the purpose of determining whether any bromsulfoldin was retained by the blood. He stated the blood was examined 30 minutes, 45 minutes and 60 minutes after the injection. He said that this is one of the tests to deter-

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<sup>15</sup> Dr. Bollman testified that when he performed the operation on these dogs he concluded that their livers were functioning properly. He said his conclusion was based upon his experience in performing numerous similar operations (R. 12940, Vol. IV, 1393-1394).

<sup>16</sup> In addition to those two tests to determine whether the dogs' livers were functioning, Dr. Bollman performed autopsies on these dogs and testified that from examination of the contents of their colons, their livers were functioning properly during the tests, so as to carry on normal digestion. He stated that there was no residue of fat in the colon above that which was normally to be expected when the liver was secreting sufficient bile. (R. 15373, Vol. VIII, 3433-3442).

mine whether or not the liver will remove bromsulfoldin from the blood at a normal rate—if it does, the liver is functioning normally; if it does not and bromsulfoldin is found in the blood, then the liver is not functioning normally (R. 15373, Vol. VI, 2463-2466).

Dr. Bollman stated that the bilirubin retention test was for the purpose of determining whether bilirubin was present in the blood of these dogs; that the normal blood of a dog contains no bilirubin, and if bilirubin is present, it indicates that bilirubin has not been secreted by the liver but reabsorbed by the blood. He said that this is the liver functioning test to determine whether or not the liver is excreting bile pigments properly. He stated that the dog plasma is perfectly clear; that if the dog plasma has a yellow color it indicates that bilirubin is present and that the dog's liver is slightly but very definitely impaired; that if the plasma is water clear it indicates that the liver was functioning normally and that there was no impairment thereof (R. 15373, Vol. VI, 2466-2467).

Dr. Bollman stated that if the operations performed on these dogs had so injured their livers as to prevent the flow of bile, there would have been bile pigment and bromsulfoldin in the blood (R. 15373, Vol. VIII, 3428-3429).

Dr. Bollman stated that the result of these liver functioning tests upon these dogs established the fact that the livers were functioning properly since there was no bromsulfoldin or bile pigment in their blood (R. 12940, Vol. IV, 1392-1395, 1396-1397, 1406).

At the conclusion of his experiments on the dogs, Dr. Bollman performed autopsies on these dogs. He stated that from these autopsies the colon of the dog had no fat content "as high as one would expect if fat had not been absorbed." (R. 15373, Vol. VIII, 3440-3442). This indicates that there was sufficient bile present in the gastrointestinal tract to provide for the absorption of fat. When asked if there was sufficient bile in the intestines of the three dogs to carry on the functions of bile in the digestive

system, Dr. Bollman replied: "Yes, I am sure that there was sufficient bile in the gastro-intestinal tract to carry out all of the digestion functions of bile in these dogs during the entire course of the experiments" (R. 15373, Vol. VIII, 3422).<sup>17</sup>

Dr. Bollman testified that the failure of bile to flow into the duodenum would cause the human being to have larger stools and softer stools and more frequent stools (R. 15373, Vol. VIII, 3407-3408). Obviously, this is different from constipation. Dr. Bollman's conclusion that there was no relationship between constipation and bile flow corresponds with the testimony of petitioner's witness, Dr. Crandall, who testified that he did not think "constipation under any circumstances decreased the flow of bile to such an extent that there is not sufficient bile in the duodenum to carry on the function of bile in the human digestive process." He stated that he knew of no evidence indicating that constipation would so decrease the secretion of bile (R. 12940, Vol. IV, 1672).

#### c. Petitioner's Laxative Pills Will Have No Effect Upon the Gall Bladder

The Commission found (R. 15373, Vol. I, 303) that petitioner's laxative pill will not cause the gall bladder to contract or cause relaxation of the sphincter of Oddi or prevent its contraction in the first instance or serve in any way to milk bile from the ampula of Vater or the bile duct, and concluded that petitioner's laxative pill will not increase the flow of bile or any constituent thereof into the duodenum. This finding of the Commission is supported by the uncontradicted opinion of qualified experts.

Dr. Carlson testified that petitioner's laxative pill will not cause the laxation of the sphincter of Oddi muscles,

<sup>17</sup> In its brief (pp. 99-100) petitioner contends that Dr. Bollman's testimony as to the autopsies he performed was improperly received because he did not produce supporting data. A short reply to this, if any is needed, is that at the time of Dr. Bollman's testimony, petitioner made no objection to the receipt of his testimony.

that irritants such as aloes and podophyllum would cause the reverse. He stated that to his knowledge, or the knowledge of literature, there was no substance in petitioner's laxative pill which would cause the gall bladder to contract and force bile into the intestine. He stated that this was the consensus of competent, informed medical opinion (R. 12940, Vol. I, 373-374).

Dr. Carlson further testified that "the evidence is to the effect that these drugs have no effect on the emptying of the gall bladder." He stated that he knew of no conflict of competent, informed medical opinion as to this action of aloes and podophyllum upon the gall bladder. He said "that there is no action on the gall bladder, or the mechanism of the gall bladder by these two drugs, singly or combined." He stated that this is the consensus of competent, informed medical opinion (R. 12940, Vol. I, 358, Vol. II, 502-503).

Dr. Ivy testified that in his opinion aloes and podophyllum in petitioner's laxative pill will not aid in the evacuation of the gall bladder and that this represented the consensus of modern, informed, competent medical opinion (R. 15373, Vol. II, 490-494; R. 12940, Vol. II, 726). Dr. Carlson testified that the drugs aloes and podophyllum were at one time considered cholagogues but "not any more." He stated that this was the opinion some 50 or 60 years ago "but with a better understanding of the machinery of the liver and the machinery of the evacuation of the bile, that is changed" (R. 12940, Vol. II, 489-490).

Dr. Ivy testified that he was familiar with modern text books on Pharmacology and they classified aloes and podophyllum as "irritant cathartics." He stated that podophyllum is not considered to be a cholagogue at the present time and that aloes has never been referred to "as a cholagogue in any of the text books of pharmacology or *materia medica*" (R. 12940, Vol. II, 556-557).

Dr. Carlson and Dr. Ivy testified that there is no substance in petitioner's laxative pill which would cause the

formation of cholesystokinin, the hormone which causes the gall bladder to contract (R. 12940, Vol. I, 369-370; Vol. II, 553, 721).

In addition to this uncontradicted opinion of these experts, the record contains experiments performed by scientists which demonstrate that petitioner's laxative pill will have no effect upon the contracting or emptying of the gall bladder.

i. Experiments Conducted by Dr. Ivy to Determine if Petitioner's Laxative Pill Will Have Any Effect Upon the Gall Bladder

Dr. Ivy conducted a series of three experiments upon a group of large dogs for the purpose of determining whether aloes and podophyllum (1) would cause the liver to secrete or form bile, and (2) would cause the gall bladder to contract.

Dr. Ivy anesthetized the dogs and inserted a canula into the dome of their gall bladders so that the contraction of the gall bladder could be graphically recorded. He "put a canula in the common bile duct" so that the bile coming from the liver could be collected and graphically recorded. The gall bladders of these dogs were not taken out (CX 98, p. 1; RX 13; R. 12940, Vol. II, 627-630). Dr. Ivy was asked if the fact that the dogs were anesthetized would make any difference, to which he replied: "No." (R. 15373, Vol. II, 717).

With the dogs thus prepared, Dr. Ivy injected into the dogs the hormone cholesystokinin, which causes the gall bladder to contract and the hormone secretin, which causes the liver to secrete bile (R. 12940, Vol. II, 629). When Dr. Ivy was asked why he used these known stimuli on the gall bladder and the liver, he replied: "We wanted to be sure that the animal was responsive, had a responsive liver and gall bladder before proceeding with the experiment" (R. 15373, Vol. II, 717). Dr. Ivey went on to say that to determine the effect of an unknown substance, such as petitioner's laxative pill, on the gall bladder or on the liver is to compare the effect of the unknown sub-

stance with the effect of the known substance, chloesytokinin and secretin (R. 12940, Vol. II, 717), and that this was an improved method of carrying out such a test (R. 15373, Vol. II, 717).

*After the effects of the injections of cholesystokinin and secretin had worn off* (R. 12940, Vol. II, 630) six of petitioner's laxative pills were ground and dissolved in alcohol, diluted with water and injected intravenously twelve times in seven dogs. Dr. Ivy stated that the alcohol was used because podophyllum is a resin and will not dissolve appreciably in water. He stated that the same amount of alcohol was used as was used during the control period; that the alcohol when injected slowly, as it was done, had no effect during the control period (R. 12940, Vol. II, 634-635).

When Dr. Ivy was asked whether or not the injection of six of petitioner's laxative pills as above described, had any effect upon the flow of bile or contraction of the gall bladder, he replied: "No." (Id. at 634).

A half an hour after the above test was made, the same solution consisting of four of petitioner's laxative pills was introduced into the duodenum of the dogs by means of a syringe and needle (R. 12940, Vol. II, 634-635). The gall bladder was observed for half an hour; then the duodenal injections were repeated. Dr. Ivy testified that the duodenal injections had no effect on the gall bladder. In four of the experiments on seven dogs, a solution equivalent to two of petitioner's laxative pills was injected intravenously and repeated in about 10 minutes. The dogs were observed for 3 hours or more (CX 98, p. 2; R. 12940, Vol. II, 627-643).

When Dr. Ivy was asked what were the results of this first series of seven experiments, he replied that there was nothing in petitioner's laxative pill "which, when administered intravenously in alcohol solution or which when introduced into the duodenum caused the contraction of the gall bladder or resulted in the flow of bile or the formation of bile by the liver" (R. 12940, Vol. II, 636).

*After the effect of the above experiments on the dogs had worn off*, a second series of experiments were performed. Twelve experiments were performed in which four of petitioner's laxative pills were ground, dissolved in water at body temperature and slowly injected into the duodenum. Dr. Ivy stated that water was used for these experiments instead of alcohol for the purpose of trying petitioner's laxative pill "in various media." He said that later on we digested them in two different ways (R. 12940, Vol. II, 641-643). After one and one-half to two hours, 2 of petitioner's laxative pills were dissolved in a solution of alcohol and water and injected slowly intravenously into the dogs.

After the completion of the above series of experiments a third series was performed using the same control period and the same injections of cholesystokinin and secretin as were carried out as in the other experiments. Four of petitioner's laxative pills were ground in 2 cc. of pancreatic juice and 0.05 cc. bile, "incubated for 1 to 6 hours in a water bath maintained at 37°C." after which the solution was injected into the duodenum (R. 12940, Vol. II, 643-647).<sup>18</sup>

When Dr. Ivy was asked the results of this series of experiments, he said that petitioner's laxative pills "administered intravenously or intraduodenally in appropriate solution do not influence the formation of bile or the pressure on the gall bladder, or cause the gall bladder to contract" (CX 98, p. 23; R. 12940, Vol. II, 642).

<sup>18</sup> Petitioner criticizes (Br. pp. 21-25) the "mixtures" which Dr. Ivy injected into the dogs. There is no merit to this criticism. Dr. Ivy, who was recognized by petitioner's witness Dr. Crandall as "one of the outstanding experimental physiologists in the world," (R. 15373, Vol. VII, 2896), testified that the mixture used is the same as is found in the duodena of dogs and human beings; it would facilitate digestion of the pills, that is, "the way a scientist approaches the problem" (R. 12940, Vol. II, 644, 645-648). Petitioner offered no evidence that the "mixture" was not proper.

ii. Experiments Conducted by Dr. Case to Determine if Petitioner's Laxative Pill Will Have Any Effect Upon the Gall Bladder<sup>19</sup>

Dr. Case performed a series of experiments on 7 human beings, including himself, for the purpose of determining whether petitioner's laxative pill had any effect upon the gall bladder. He used the Graham-Cole method of visualizing the gall bladder by means of the X-ray. Dr. Case stated that although this method is primarily used for diagnostic purposes "it is the best method there is" for testing the efficacy of drugs on the function of the liver and gall bladder and on the integrity of the gall bladder (R. 12940, Vol. I, 404-405; R. 15373, Vol. VII, 3093-3094, Vol. VIII, 3149).

Dr. Case had the subjects, on the afternoon of the day before the X-ray examination, take a gall bladder dye which made it possible to visualize the bile concentrated in the gall bladder. The subjects had a carbohydrate meal, so that there would be no effect of the meal upon the gall bladder. Bile accumulates and becomes concentrated in the gall bladder when the subject is fasting or has had only a carbohydrate meal (R. 12940, Vol. I, 1404-1406).

Before breakfast the next day the first X-ray picture was taken of the subjects' gall bladders (CXs 99, 102, 106, 108, 112, 115 and 118).<sup>20</sup> Immediately after the X-ray picture was taken, the subjects were given 3 of petitioner's laxative pills—in one case 6 of these pills. 2, 4 or 5 hours there-

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<sup>19</sup> Petitioner attempts to convince the Court (Br. 44-49) that Dr. Case was so biased and prejudiced that his testimony was unworthy of belief. This same contention was made before the Commission. The Commission rejected it and in doing so held that "Dr. Case's status as an eminent radiologist and his high qualifications to conduct and evaluate scientific research work was apparent from the record. . . . the views expressed by [Dr. Case] constituted sincere scientific interpretations and opinions reached by him on the basis of his years of medical experience and training." (R. 15373, Vol. I, 297).

<sup>20</sup> CX 99, R. 12940, Vol. I, 411-412, 414; CX 102, Id. 423-424; CX 105, Id. 428-429; CX 108, Id. 432-433; CX 112, Id. 438, 441-442; CX 115, Id. 439, 446; CX 118, Id. 450-451.

after, with the subject still fasting, a second X-ray picture was taken (CXs 100, 103, 106, 109, 113, 116, 119, 120).<sup>21</sup> The second X-ray picture was made to determine "what influence the administration of these pills had upon the gall bladder" (R. 12940, Vol. I, 408). After the second X-ray picture was taken the subjects ate a fat meal and from 30 minutes to an hour thereafter, the third X-ray picture was taken (CXs 101, 104, 107, 110, 114, 117, 121).<sup>22</sup>

Dr. Case testified that a fat meal "calls for bile for assistance in digestion and when the fat gets into the stomach and starts passing on down to the small bowel, there is a reflex process which calls upon the gall bladder . . . [the] sphincter opens up and the gall bladder contracts and bile passes on into the intestine." He said the X-ray disclosed a change in the size of the gall bladder (R. 12940, Vol. I, 409).

The results of Dr. Case's tests showed that petitioner's laxative pill had no effect on the gall bladder, whereas the pictures taken 30 minutes after a fat meal showed that the gall bladders of all the subjects were greatly reduced in size.<sup>23</sup>

When Dr. Case was asked as to the effect of petitioner's laxative pill on the gall bladder, the evacuation of the gall bladder, and the flow of bile from the gall bladder as shown by his X-ray experiments, he replied: "It has no effect." He also added that the tests showed that petitioner's laxative pills had no effect upon the formation of bile by the liver (R. 12940, Vol. I, 457-458).

Petitioner complains that the Commission made no report upon its challenges of the experiments and testimony

<sup>21</sup> CX 100, R. 12940, Vol. I, 417-419; CX 103, Id. 425-426; CX 106, Id. 429; CX 109, Id. 433-434; CX 113, Id. 441-442; CX 116, Id. 439, 446-447; CX 119, Id. 452-453; CX 120, Id. 453.

<sup>22</sup> CX 101, R. 12940, Vol. I, 419-420; CX 104, Id. 427; CX 107, Id. 429; CX 110; Id. 433-434; CX 114, Id. 442; CX 117, Id. 448-449; CX 121, Id. 453.

<sup>23</sup> R. 12940, Vol. I, 421-456.

of Dr. Case. There is no merit to this statement and the findings of the Commission flatly contradict petitioner in that respect. See R. 15373, Vol. I, 297-298.

Having no evidence in the record upon which it can rely to offset the impact of the experiments and testimony of Dr. Case, petitioner attempts to discredit the testimony of this witness (Br. 51-65). Petitioner contends (1) that Dr. Case "was permitted to testify, without producing the underlying records of the tests, as to the results of X-ray films made" during those tests; (2) that Dr. Case did not produce X-ray films of the tests made on subjects upon which experiments were performed. This contention is out of time.

Dr. Case identified Commission's Exhibits 99 through 110, 112 through 121 as prints of the original X-ray films and testified in reference to these. These prints were offered in evidence and petitioner's counsel stated that he would not "consent to these pictures going into evidence. . . I want to be in a position to raise whatever objections I want to later on, without having the embarrassment of having consented to their going in." All of the prints were received into evidence (R. 12940, Vol. I, 412, 418-420, 440-441). Upon the completion of the cross-examination of Dr. Case, counsel in support of the complaint stated that references had been made concerning the original films and he would like to introduce into evidence the original films from which Commission's Exhibits 99 through 121, except Exhibit 111, had been made. Petitioner's counsel said: "No objection." (R. 15373. Vol. II, 610). The examiner upon that statement admitted the original films into evidence as Commission's Exhibits 125 through 146. It is too well settled as to require either citation of authority or argument that in order to take advantage of any error that might result in the admission either of testimony or exhibits, objections must be made at the time such testimony or exhibits are offered in evidence. In the instant matter petitioner's counsel stated there was no objection.

He is now estopped from raising any question as to the validity or credibility of either the testimony of Dr. Case or the authenticity of the films. In *Noonan v. Caledonia Gold Mining Co.*, 121 U.S. 393, 400 (1887) the Supreme Court said:

"The rule is universal, that where an objection is so general as not to indicate the specific grounds upon which it is made, it is unavailing on appeal, unless it be of such a character that it could not have been obviated at the trial. The authorities on this point are all one way. Objections to the admission of evidence must be of such a specific character as to indicate distinctly the grounds upon which the party relies, so as to give the other side full opportunity to obviate them at the time, if under any circumstances that can be done."

Had petitioner made a specific objection to the introduction of these exhibits or to the testimony of Dr. Case at the time the exhibits and his testimony were introduced into the record, the underlying records could and would have been made available to petitioner (R. 15373. Vol. VIII, 3135-3136). Had petitioner complained that Dr. Case had not produced all of the X-ray films at the time Dr. Case testified, these additional X-ray films could and would have been made available to petitioner. Petitioner's objections here come some ten years too late.

We note some of petitioner's criticisms of the experiments conducted by Dr. Case. Petitioner criticizes the Commission for permitting Dr. Case to testify in reference to X-ray films which he himself did not take (Br. p. 57). There is no merit to this. The series of X-ray films on three of the subjects were made in Dr. Case's office, and either he took them or they were taken in his presence; he testified in the minutest details as to the procedure followed (R. 15373, Vol. II, 529-530). The X-ray films for the other four subjects were made at Northwestern University in the Department of which Dr. Case was the head (id. 514);

all were made by either of two technicians (id. 534-535) whose names appear on the X-ray films themselves (id. Vol. VII, 3050-3051). In its opinion (id. Vol. I, 320-321) the Commission pointed out that Dr. Case was well qualified to testify regarding the X-ray films.

Petitioner also criticizes the interpretation made by Dr. Case of the X-ray films as well as the protocol of the experiments, stating that sufficient time had not elapsed between the giving of the pills before Dr. Case took the second series of X-ray pictures to establish that it was not the pills but the fat meal which caused the gall bladders of the subjects to appear shrunken in the third series of pictures (Br. pp. 59-66). There is no merit to this. Dr. Case stated specifically that from the thousands of gall bladder tests he had made by the method employed in these experiments it was a "reasonable and entirely logical *conclusion that it was the fat meal that did the contracting and not*" petitioner's laxative pills. (R. 15373, Vol. VII, 3105-3106). Dr. Case further testified that if a drug has any cholagogic effects, the gall bladder will begin the process of emptying when the drug is taken by mouth from six to ten minutes after the cholagogic is taken (Id. Vol. VIII, 3149, 3150).

**d. Petitioner's Laxative Pill Will Not Affect the Flow of Bile in Any Manner**

The Commission found, and it is not contradicted in the record, that the various ways in which an increase in the flow of bile into the duodenum can be brought about are: (1) to stimulate the formation or secretion of bile by the liver; (2) to cause the gall bladder to contract; (3) to cause the sphincter of Oddi to relax; (4) to irritate the intestine in such manner as to eliminate the reflex action which causes contraction of the sphincter of Oddi; and (5) to milk the bile from the bile ducts or from the ampulla of Vater by increasing the motility of the duodenum. (R. 15373, Vol. I, 277).

Dr. Carlson testified that the sphincter of Oddi is a circular muscle surrounding the common bile duct in the wall of the duodenum. When it contracts it compresses the

lumen of the bile duct so that bile cannot escape (R. 12940, Vol. I, 459-461).

Dr. Ivy testified that the ampulla of Vater "is a little dilation or enlargement in the portion of the common bile duct just before the common bile duct opens into the [lumen] of the intestine." (R. 12940, Vol. II, 528-529).

Dr. Ivy also testified that on the basis of his knowledge "[Petitioner's laxative] Pills or aloes and podophyllum do not relax the sphincter of Oddi." (R. 12940, Vol. II, 720-721). He said there is no proof that [Petitioner's laxative] Pills caused "sufficient irritation of the colon to bring about reflex contraction of the sphincter." (R. 12940, Vol. IV, 1519, 1532).

Having determined by various experiments hereinabove set out that neither petitioner's laxative pill nor the two drugs of which it is composed would have any effect on the formation of bile by the liver and on the gall bladder's contraction, and to complete his studies on the subject of the therapeutic effect of petitioner's laxative pill, Dr. Ivy performed 10 experiments on 6 jejunal fistula dogs to find out "whether or not the passage of [petitioner's laxative pills], or their ingredients, through the duodenum might act to relax the sphincter of Oddi, or to increase the motility of the duodenum . . . or affect the sphincter in such a way that the flow of bile into the duodenum might be increased" (R. 12940, Vol. IV, 1499).

Each dog was anesthetized and the jejunum was cut approximately 24 inches below the outlet of the stomach. The distal portion of the section was closed and the proximal portion was brought to the outside through a stab wound.

"A snugly fitting funnel was placed around the fistula for purposes of collection of the secretions." The secretions passed into the duodenum down to the jejunum and out through the jejunal fistula. (R. 12940, Vol. IV, 1500) After the dogs had fully recovered from the anesthetic, the tests were begun. The first 4 hours constituted the

control period. The next 4 hours constituted the test period. During the control period each dog was given 100 ccs. distilled water by stomach tube every hour for 4 hours. At the end of each hour the secretions were collected, measured and tested for bilirubin and for cholic acid.

The test period started at the beginning of the fifth hour, at which time each dog was given by means of a stomach tube, 100 ccs. of distilled water in which 4 of petitioner's laxative pills were suspended. This was repeated at the beginning of each hour. At the end of each hour the secretions were collected, measured and tested by scientific methods for bilirubin and for cholic acid (R. 12940, Vol. IV, 1500-1501). Dr. Ivy stated: "The bilirubin determination in the hourly drainage was determined in all tests, and the cholic acid was determined in tests only in 3 dogs" (Id. at 1503).

Dr. Ivy testified that the results of these tests indicated that there was an increase in volume of secretion collected during the test period as compared with the volume collected during the control period. He stated that while this increase was mathematically significant ". . . it is not physiologically significant . . . Because there was no increase in the bile pigment in the drainage, nor in the cholic acid in the drainage, after the administration of [petitioner's laxative pills]" (R. 12940, Vol. IV, 1508-1509). Dr. Ivy further said ". . . the average figures on bilirubin output and cholic acid output per hour simply indicates or shows clearly that the increase in the volume was not due to an increase in the flow of bile in the duodenum." (id. at 1510). Dr. Ivy stated that the tests made on these dogs could be translated to man, "because he knows of nothing which increases the flow of bile into the duodenum of dogs which does not do so in the case of man, and vice versa" (Id. at 1513).

From his experiments Dr. Ivy concluded that petitioner's laxative pill did not increase the flow of bile into the duodenum by "milking" bile out of the common bile duct (R.

12940, Vol. IV, 1512-1513) or the ampulla of Vater (Id. 1628-29).

The above is a summary of the evidence upon which the Commission relied to make its finding that petitioner's laxative pill will not affect the flow of bile.

In its effort to establish that its laxative pill will affect the flow of bile, petitioner introduced the experiments and testimony of Drs. Killian, Hazelton and Morrison.

Dr. Killian, who petitioner says was its "key witness" (Br. p. 112), testified that petitioner's laxative pill will increase the flow of bile if three conditions are present at the same time. Petitioner does not quote Dr. Killian, but summarizes in its own language the three conditions and then tells the Court (Br. p. 107): "Now, of course, these were the very conditions in which petitioner's product was intended, designed and claimed to benefit." It is extremely difficult to believe that petitioner is serious in this statement. It indicates, however, the desperate straits in which petitioner finds itself in its attempt to offset the overwhelming weight of the evidence in the record upon which the Commission based its finding that petitioner's laxative pill will have no effect on the formation or flow of bile.

In substance, Dr. Killian testified that the results of his experiments indicated that petitioner's laxative pill will increase the flow of bile when taken under three conditions —all three of which must be present and complied with at the same time.

**First Condition.** Petitioner's laxative pill must be taken in sufficient doses over a sufficient period of time to "produce laxation either within normal limits of fresh weight stools or the maximum laxative effect" (R. 12940, Vol. III, 1305). Dr. Killian stated that to accomplish this, 5 of petitioner's laxative pills must be taken every day for 1 week. He admitted that what is a normal limit of fresh weight stools varies in the individual and from time to time (id. at 1292, 1329). Dr. Killian stated that he was

not willing to say that if a person met this requirement that it would mean the flow of bile would be increased (Id. at 1236).

**Second Condition.** "The rate of flow of bile into the duodenum will be increased in individuals and, only in individuals who show during periods within which they have been taking no [petitioner's laxative] pill 'low values' for the biliary constituents in the duodenal fluid in response to a stimulus introduced into the duodenum of the type of Pep-tone" (R. 12940, Vol. III, 1305). It is obvious that the only way this condition can be met is by having a duodenal drainage performed. This can only be done in a laboratory or a hospital. Dr. Killian admitted that unless the purchaser of the pills had had duodenal drainage performed, he would not know whether such drainage was high or low and unless he did know, he would not be in a position to tell whether petitioner's laxative pill would have any effect upon the flow of bile (id. at 1250). Again Dr. Killian was not willing to say that even though this second condition was met together with his other conditions, petitioner's laxative pill would secure an increase in bile flow (Id. at Vol. IV, 1361).

**Third Condition.** Petitioner's laxative pill will increase the flow of bile "in individuals who show signs during periods in which they are not taking [petitioner's laxative pill] of diminished rates of intestinal motility as indicated by abnormally low fresh weight stools and symptoms depending upon the abnormally low rate of intestinal motility" (R. 12940, Vol. III, 1305-1306). This condition of Dr. Killian is difficult of interpretation. Petitioner interprets it to mean "that the individual be one who shows signs when not taking the pills of low or diminished rates of intestinal mobility [sic], as indicated by abnormally small stools or absence of stools" (Br. p. 107). Just as in the other two conditions, this condition is impossible of practical fulfillment. There is no definite standard applicable to all persons as to what is a diminished rate of intes-

tinal motility. Different periods of time, as Dr. Ivy testified, are required for different persons for the fecal matter to pass through into the intestines (id. Vol. IV, at 1557). Dr. Ivy also testified there are no specific signs or symptoms of "diminished rates of intestine motility" (Id. at 1557-1559).

The end result of the experiments and testimony of Dr. Killian is that petitioner's laxative pills would increase the flow of bile *only when taken under the three above-described conditions.* It is difficult, if not impossible, for a purchaser of petitioner's laxative pill to meet those requirements. There is nothing in the record which establishes the fact that petitioner in its directions for use advises a purchaser that before he can obtain the relief he seeks he must comply with all of the three conditions testified to by petitioner's chief witness, Dr. Killian. Further than this, Dr. Killian would not state that petitioner's laxative pill would increase the flow of bile when either one, two or all of those conditions were actually met. (R. 12940, Vol. III, 1326).

Petitioner introduced the experiments and the testimony of Dr. Lloyd W. Hazelton in support of its contention that this laxative pill will increase the flow of bile. The method and procedure followed by Dr. Hazelton established the fact that neither his experiments nor his testimony are material or relevant to the issue here.

Dr. Hazelton injected aloes and podophyllum intravenously into the dogs. He testified that from his experiments he could not tell whether or not aloes and podophyllum taken duodenally had any effect upon the flow of bile (R. 15373, Vol. II, 794). Dr. Hazelton testified that from his experiments he could not and did not determine whether petitioner's laxative pills taken orally would have any effect upon the flow of bile (id. at 795) and, reiterated, that his experiments offered no proof at all that petitioner's laxative pills taken orally would have any effect whatever (id. at 816). Since in his experiments Dr. Hazelton injected

aloes and podophyllum intravenously into the dogs and in the experiments conducted by the Commission's witnesses these drugs or petitioner's laxative pills were injected into the duodenum of the dogs, the experiments are totally different. There is no conflict between the results obtained. Dr. Hazelton's experiments are not relevant.

An examination of the testimony of Dr. Morrison will convince the Court that it cannot properly be characterized as reliable evidence. Dr. Morrison received a fee of between \$17,500 and \$20,000 from petitioner for experimental work. (R. 12940, Vol. III, 1092, 1093). Patients had been referred to Dr. Morrison by other physicians for treatment. Without the knowledge of these patients or consent, he subjected them to the duodenal drainage and the administration of petitioner's laxative pills for the furtherance of the project for which he had been employed and paid by petitioner. He also charged these patients for services. Dr. Morrison did not inform the physicians of these patients that he was using the patients for the purpose of his experiments (R. 12940, Vol. III, 1101-1102, 1113, 1117, 1129, 1133-1134).

After testifying for 4 days in which he submitted the entire case histories of the 53 patients upon which he performed his various experiments (R. 12940, Vol. III, 1109-1112), Dr. Morrison objected to further testifying and employed a personal counsel to make this objection (R. 15373, Vol. III, 1313-1317). When a motion to strike Dr. Morrison's testimony was made, petitioner's counsel objected and filed an affidavit in support of his objection (Id. Vol. I, 11-14).

Dr. Morrison testified (R. 12940, Vol. III, 1108) that he made his laboratory findings in 1941 and wrote them up on stationery which bore his postal zone number in Philadelphia.<sup>24</sup> It was stipulated on the record that postal zones

<sup>24</sup> PX 136E, R. 12940, Vol. III, 1108; PX 137E, id. at 1108; PX 138E and F, R. 15373, Vol. III, 1139; PX 140E, id. at 1155; PX 146C, id. at 1199-1200; PX 147B, id. at 1202-1203; PX 160F, id. at 1276. PX refers to Respondent exhibits.

were not adopted by the Post Office Department in Philadelphia until May 1943 (R. 15373, Vol. III, 1135)—2 years subsequent to the time Dr. Morrison testified he wrote up the laboratory findings. For other testimony of Dr. Morrison establishing his unreliability, see R. 12940, Volume III, 1117, 1130-1131; R. 15373, Volume III, 1204-1206, 1275.

Those are the three witnesses whose testimony petitioner relies upon to establish the fact that its laxative pill will increase the flow of bile.

The above summary of the only evidence introduced in the record by petitioner on the issue of flow of bile establishes: (1) The conditions which Dr. Killian stated would have to be present in order for petitioner's laxative pill to increase the flow of bile are wholly unrealistic and impossible; (2) The tests performed by Dr. Hazelton are not relevant because the aloes and podophyllum were introduced intravenously into the dogs. Petitioner's laxative pills are not sold to be used by the purchaser in that manner and there is nothing in the record to indicate that they ever have been so used; and (3) The record discloses that the testimony of Dr. Morrison cannot properly be characterized as substantial evidence.

We, therefore, submit that the findings of the Commission that petitioner's laxative pills will have no effect on the formation or flow of bile is not only based upon substantial evidence but upon the only reliable evidence in the record relevant thereto.

## **2. Petitioner Was Not Denied a Fair and Impartial Hearing**

Under Point II (Br. pp. 114-145) petitioner contends that it was denied a fair and impartial hearing. As we read petitioner's brief, the basis for its contention is: the examiner (1) made rulings adverse to petitioner; (2) used objectionable language; (3) adopted the contention of counsel supporting the complaint; (4) denied petitioner's offer of proofs; and (5) refused to admit certain evidence.

Petitioner states (Br. p. 122) that the decision of this Court in *Carter Products, Inc. v. Federal Trade Commis-*

sion, 201 F.2d 446 (C.A. 9, 1953), held that petitioner had been denied a fair trial, for reasons other than the curtailment of the cross examination of Drs. Case, Bollman and Lockwood. The opinion of the Court will not support this statement. At page 454, the Court said: "It is argued that there was ample evidence from other quarters to sustain the findings and order of the Commission, hence the rulings, even if wrong, were not prejudicial. We are of the opinion, however, that the cumulative effect of these unjustifiable restrictions on the cross-examination of key witness for the Commission was to deprive petitioner of a fair hearing."

In its order reopening this matter after receiving the remand from this Court, the Commission remanded the case to hearing examiner James A. Purcell (R. 15373, Vol. I, 31). Petitioner raised no objections to this at the time nor was any objection made at any time during the course of the hearings. It was not until the examiner closed the record that petitioner filed its motion before the Commission seeking disqualification of the examiner (id. 145-147). The contention that the examiner was biased and prejudiced relates, therefore, to the hearings on remand.

The Court should bear in mind that this case was heard by the Commission under a procedure in which the examiner files only a recommended decision as provided by the rule of the Commission in effect when the proceedings were instituted.<sup>25</sup> The examiner in the instant matter did not make an initial decision as under the present procedure. Here the Commission made its own findings as to the facts, its own conclusions and issued its own order to cease and desist. The alleged bias and prejudice of the examiner,

<sup>25</sup> "The trial examiner shall within 15 days after receipt by him of the complete stenographic transcript of all the testimony in a proceeding, make his report upon the evidence. . . . the trial examiner's report is not a report or finding of the Commission. Such report is advisory only and is not binding upon the Commission" (16 C.F.R. Sec. 2.20, Cum. Supp., June 2, 1938, June 1, 1943; 6 F.R. 832 (February 4, 1941).

therefore, even if true, is immaterial. In *National Labor Relations Board v. Air Associates, Inc.*, 121 F.2d 586, 588 (C.A. 2, 1941), the Court said:

“ . . . Even if bias against respondent was manifested in the examiner’s intermediate report and recommendations, that bias became immaterial, since the Board ignored that report and relied solely and directly on the evidence in the record. . . . That the Board disregarded the examiner’s report serves to answer respondent’s objections concerning bias, if any, disclosed in his report. . . .”

In *National Labor Relations Board v. Ford Motor Company*, 114 F.2d 905 (C.A. 6, 1940), cert. denied 312 U.S. 689, the Court said:

“ . . . Not all departures from strict propriety . . . justify a reviewing court in setting aside decision in a hearing upon which so much time and effort has been spent as upon this. Material prejudice to the interest of the complaining litigant must clearly appear. It may be conceded that the trial examiner in the present case overstepped the bounds of that judicial propriety which contestants have a right to expect not only from courts but from administrative tribunals, and is so conducive to public confidence in their adjudications, and that he manifested a peculiar concept of the nature of the judicial function he was called upon to exercise. Indeed, the Board does not condone his lapses. *We must keep in mind, however, that ultimate decision was not his but that of the Board.* . . .” (Id. at 909) (Emphasis supplied.)

We submit, therefore, that any bias and prejudice of the examiner which may have existed cannot form a basis for a determination that petitioner was denied a fair and impartial hearing unless the examiner committed some act either in refusing to admit testimony, exhibits or in restricting the rights of petitioner in some manner resulting in prejudicial error. Adverse decisions, statements and

comments made by examiner do not form the basis of a charge of personal bias and prejudice, *Berger v. United States*, 255 U.S. 22, 31.

In the Air Associates, Inc. case (121 F.2d 586, 590 (C.A. 2, 1941) the Court held that "over jealous scrutiny of every word that may fall from the judge's mouth" is not compatible with the Court's duty in insuring impartial conduct of the trial.

The fact that the Commission's findings of fact were in accord with the position advocated by counsel in support of complaint and against the position advocated by petitioner's counsel, cannot form the basis of a charge of personal bias or prejudice. If it could, this is, in effect, saying that whenever a decision goes against an advocate it establishes bias or prejudice of the Court or agency making the decision. This statement carries its own absurdity. In *Williapoint Oysters v. Ewing*, 174 F.2d 676 (C.A. 9, 1949), cert. denied 338 U.S. 860, this Court said at page 689:

Merely because the findings were in accord with the contentions and evidence of the Government does not demonstrate to us that the Administrator considered only Government evidence and disregarded that of petitioner.

Petitioner further contends that the fact that the examiner refused to admit into evidence articles and excerpts from so-called "textual authorities" established his bias and prejudice. There is no merit to this. As a matter of fact, although the examiner did refuse to admit the articles in evidence, as such, he did permit petitioner's counsel to read excerpts from 14 different "textual authorities," asking Dr. Bollman in each instance whether or not he agreed with them (R. 15373, Vol. VIII, 3183-3200, 3202, 3206). The admission into evidence of these "textual authorities" could not have accomplished any greater purpose than was accomplished by reading excerpts therefrom. Petitioner had full advantage of these articles to test Dr.

Bollman as to whether or not he agreed or disagreed with the statements.

Insofar as the offer of these articles was for the purpose of establishing the truth of their contentions, this Court stated in *Carter Products, Inc. v. Federal Trade Commission*, 201 F.2d 446, 449 (C.A. 9, 1953) :

“The general view is that medical treatises are not in themselves competent evidence since they constitute statements made out of Court by persons not available for cross examination.”

If they were offered in evidence for the purpose of impeaching Dr. Bollman, the admission of them was within the discretion of examiner and his refusal did not amount to an abuse of discretion. (Id. at 248-249).

Petitioner further contends that in refusing to admit into evidence the testimony of a statistician and the testimony and experiments of Dr. Twiss, the examiner disclosed personal bias and prejudice. This is without merit.

The purpose of the additional hearings was to correct the errors laid bare by this Court's review. After this was accomplished, petitioner offered the testimony of a statistician and the testimony and experiments of one Dr. Twiss. Counsel for the Commission (R. 15373, Vol. I, 237-238) said he would offer no objection if this was newly discovered evidence. Then when the proceeding came before the Commission, it took some pains during oral argument to ascertain whether petitioner had something concrete to offer in the way of evidence. One of the Commissioners during argument asked petitioner's counsel the following: “. . . I was wondering if you could make a statement to the Commission which would perhaps satisfy the requirements of that rule [in reference to the admission of this proposed evidence], and perhaps demonstrate by a statement its materiality and the reasons why it wasn't produced at the original hearing.” To which petitioner's counsel replied: “. . . It wasn't available. It

hadn't been done at the time of the original hearing. . . . I have asked the Commission in my appeal to do two things: Either dismiss the complaint in its entirety because of the conflict of scientific proof, or if that not be done, then to start it all over again before another trial examiner. . . . I don't care to take advantage of the suggestion made by [counsel supporting the complaint] and on what my position will be with respect to that evidence, I would like to reserve decision." The Commission then asked if counsel stated that this proposed evidence is material and presently available. To which petitioner's counsel replied: "Yes, the evidence is presently available and is very material" (R. 15373, Vol. VIII, 3495-3497). The Commission in its opinion, speaking through Commissioner Kern (R. 15373, Vol. I, 326), said: ". . . The Commission having determined that [petitioner's] motion to disqualify the hearing examiner was not well taken, we must reject the [petitioner's] contention that it is entitled to a trial de novo. [Petitioner] having elected not to pursue the matter further by filing for our consideration a proper motion and having an evident intent to rely on the rulings below as constituting prejudicial error invalidating all prior proceedings herein, it was appropriate that the Commission proceed to a consideration of the case on its merits. This the Commission has done and its decision, representing the results of its own extensive examination of the record, is issuing herewith."

We submit that petitioner's failure to properly proceed to introduce into this record what it claimed to be after discovered evidence which would definitely establish that its laxative pill would increase the flow of bile, is a strong indication that the evidence would not establish this fact. Petitioner cannot stand aside during the course of a proceeding and then parry an adverse decision with an offer of more evidence, *Colorado Radio Corp. v. Federal Communications Commission*, 118 F.2d 24, 26 (C.A.D.C., 1941), nor can a petitioner put aside its claim of newly discovered

evidence as this petitioner did before the Commission and then parry an adverse decision with the claim of prejudice. To the same effect see: *California Lumbermen's Council v. Federal Trade Commission*, 115 F.2d 178, 183 (C.A. 9, 1940); *Dolcin Corporation v. Federal Trade Commission*, 219 F.2d 742, 747 (C.A.D.C., 1954).

## IV

### CONCLUSION

We respectfully submit that the Commission's findings that petitioner's laxative pill will have no effect on the formation or flow of bile is not only supported by the greater weight of the evidence but by the only substantial evidence in the record relating thereto; that all other findings of fact not here in issue and the prohibitions in the order based thereon are final and conclusive.

The Commission, therefore, prays that the petition to review be dismissed and that pursuant to the statute<sup>26</sup> the Court enter its decree affirming the Commission's order to cease and desist and ~~remanding~~ remanding petitioner to obey the same and comply therewith.

EARL W. KINTNER,  
*General Counsel,*  
JAMES E. CORKEY,  
*Assistant General Counsel,*  
JNO W. CARTER, JR.,  
FLETCHER G. COHN,  
*Attorneys,*  
*Attorneys for Federal Trade Commission.*

WASHINGTON, D. C., NOVEMBER 20, 1957.

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<sup>26</sup> "To the extent that the order of the Commission is affirmed, the Court shall thereupon issue its own order commanding obedience to the terms of such order of the Commission." Federal Trade Commission Act, § 5(c), 52 Stat. 113; 15 U.S.C. § 45(c).

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IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT.

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No. 15373

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CARTER PRODUCTS, INC.,

*Petitioner,*

*against*

FEDERAL TRADE COMMISSION,

*Respondent.*

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## REPLY BRIEF OF PETITIONER.

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WILLIAM L. HANAWAY,

STODDARD B. COLBY,

HERMAN PHLEGER,

ALVIN J. ROCKWELL,

*Attorneys for Petitioner.*

BREED, ABBOTT & MORGAN,

BROBECK, PHLEGER & HARRISON,

*Of Counsel.*

FILED

DEC 11 1957

PAUL P. O'BRIEN, CLERK

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IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT.

CARTER PRODUCTS, INC.,  
Petitioner,  
*against*  
FEDERAL TRADE COMMISSION,  
Respondent.

No. 15373.

**REPLY BRIEF OF PETITIONER.**

**A.**

The Commission's Brief amounts in effect to an abandonment on its part of any effort to refute, and to an admission of the irrefutable force of, the Petitioner's Specific Challenges to the Commission's Findings and Order concerning Petitioner's product claims of increasing bile flow and Petitioner's contentions of denial of due process.

The Commission's Brief makes no genuine attempt to answer the Petitioner's specific charges (a) of outright denials by the Commission to this Petitioner of due process, (b) of the plain bias and prejudgment of the issues by the Commission and its Examiner and their refusal to make any fair estimate of the worth of opposing evidence, (c) of the clear reversible error in the application by the

Commission of erroneous and dual standards of proof,\* (d) of the Commission's violations of "fair play" which is the essence of due process (*Galvan v. Press*, 347 U. S. 522, p. 523), in repetition and intensification of the same or similar unfair practices of the Commission condemned by this Court in its prior opinion in this case, (e) of the Commission's Examiner's blocking of the proper examination of key witnesses (f) of the Commission's flouting of the spirit of this Court's remand and (g) of the Commission's total failure to establish its affirmative case by the fair preponderance of substantial evidence, all fully documented in Points I and II of Petitioner's Opening Brief.

As to the remarks (Commission's Brief, pp. 62-63), concerning the Petitioner's alleged failure to make "proper"\*\*\* application to introduce the Twiss experiments demonstrating the truth of all of Petitioner's bile flow claims by his exhaustive scientific tests carefully conducted in accordance with proper and up to date scientific procedures,\*\*\* Petitioner's answer is plainly set out in Subds. D and E, pp. 134-146 of Petitioner's Opening Brief—to which the Commission's Brief makes no effective reply—to wit, that, as demonstrated in Petitioner's Briefs, on the record here shown, introduction or leave to make introduction of this new and unanswerable body of evidence before this Exam-

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\* Receiving, as an added instance of discrimination, hearsay evidence to bolster the Commission's own witness, Dr. Case (Opinion, Vol. I, N. R. 321) but rejecting Petitioner's many proffers in its Offers of Proof (*id.* 33-66) of similar evidence in the form of authoritative scientific textual authorities in support of Petitioner's witnesses.

\*\* See p. 3 Petitioner's Supplemental Brief on Appeal to the Commission, dated May 11, 1956.

\*\*\* See Vol. I, N. R. Offers of Proof and Twiss affidavit, pp. 33-66, particularly pp. 43-46, and Petitioner's Ex. for Id. No. 3, all rejected by the Examiner. Because of the importance in this case of Petitioner's Motions and Offers of Proof, the Court is respectfully urged to examine them in full.

iner, whose disqualifying bias and prejudgment of this case have now been established beyond the peradventure of a doubt, *would constitute the merest empty gesture neither affording the Petitioner due process nor any real or adequate remedy whatsoever.*

The Commission's Brief makes no attempt to answer specifically all the other self-evident, virtually admitted, and fatal defects in the Commission's evidence and experimental proof which because of the Commission's bias it ignored, nor any attempt at all to controvert the Petitioner's formidable constitutional objection based on the legislative history of the Wheeler-Lea Amendments to the Federal Trade Commission Act set out in Point III of Petitioner's Opening Brief. In this connection, added, for instance, to all the many other sharp rifts and unresolved differences in general medical opinion itself on major issues in this case disclosed by this record, some of which were conceded by the Commission's own witnesses, (Point III, *supra*, pp. 153-4) and which type of difference in general medical opinion, for the cogent reasons there set forth, *deprives the Commission of any power at all to issue a Cease and Desist Order in this case*, is this further concession by the Commission's key witness, Dr. Palmer: This witness for the Commission in effect conceded (Vol. II, N. R. Palmer 651-653) the existence in regard to one of the most vital issues in this whole suit, namely, as to whether there are certain conditions of the liver (biliary dyskinesia,\* for example) which Petitioner contends are improved by a better flow of bile, that there is a "difference of medical opin-

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\* See the authoritative statement of Dr. Henry L. Borkus, Professor of Gastroenterology, University of Pennsylvania Graduate School of Medicine, in his work "Gastro-enterology" (1946) that in this recognized condition "frequent emptying of the biliary tract should be encouraged," corroborating Dr. Morrison, but rejected by Commission and Examiner (Offers of Proof Vol. I, N. R. pps. 57, 61).

*ion*" (*id.* 652). Here, again, also, as the Court will see, (*id.* 653) the Petitioner was prejudicially blocked by the Commission's Examiner from proper further exploration, by cross examination of this witness, of further differences of medical opinion (which the witness appeared to indicate were "great", *id.* 653) as applied to the "*gastro-intestinal and biliary systems*" generally. This restriction of cross examination on so important an issue was in itself reversible error and denial of due process, *Alford v. U. S.*, 282 U. S. 687, pp. 691-2; *Reilly v. Pinkus*, 338 U. S. 269, pp. 275, 276.

By its failure specifically to answer, the Commission in effect admits, the irrefutable force of all of Petitioner's major contentions on this Appeal of the Commission's and its Examiner's bias and its denials of due process and reversible errors.

## B.

The detailed refutation (which for its protection Petitioner has been obliged to make) in Appendix "A" of this Reply Brief of the amazing array of material misstatements, omissions and distortions contained in the Commission's Brief and the analysis in that Appendix of numerous further denials of due process by the Commission constitute further demonstration of Petitioner's clear right to the relief Petitioner seeks on this Appeal.

Instead of attempting to meet Petitioner's justified attacks upon the Commission's Findings and upon its and its Examiner's improper conduct of this case, the Commission in its Brief resorts in desperation to a running series of material omissions, distortions and misstatements (and to spurious charges of misstatements by Petitioner) of such

an extreme and extensive nature that Petitioner cannot, by leaving them unchallenged, run the grave risk of this Court's being mislead by these tactics on the Commission's part.

Petitioner is, therefore, forced, both for the positive protection of its rights and also in order to avoid any implication of admissions on its part similar to the implication which arises because of the Commission's failure specifically to answer Petitioner's contentions, to refute those misstatements *seriatim*. Such detailed refutation and numerous instances of still further denials of due process on the Commission's part necessarily involved in that refutation are contained in Appendix A. The matters there set forth are of real substance and of such extremely vital importance to Petitioner's case that this Court is most earnestly and respectfully requested to read the Appendix in its entirety, among other reasons because the misunderstandings and fundamental mistreatments of the evidence in which, even in its Brief, the Commission still persists are further eloquent proofs of its bias and prejudgment.

The present appeal brings up for review by this Court all the reversible errors which lurk in this entire Record not *specifically* passed upon by this Court's former limited review. This Court's prior reversal of the Commission is not "an adjudication by the appellate court of any other than the questions in terms *discussed and decided*". \* \* \* "All questions which appear upon the record and have not already been decided are open for consideration", *Mutual Life Ins. Co. v. Hill*, 193 U. S. 551, pp. 553-4; *Hartford Life Ins. v. Blincoe*, 255 U. S. 129; *Wolff Packing Co. v. Industrial Court*, 267 U. S. 552; *American Cyanamid Co. v. Wilson and Toomer Fertilizer Co.*, 51 F. (2) 665. As this Court held in *Hansen & Rowland v. C. F. Lytle Co.*, 167 F. (2) 998, p. 999, "a judgment of reversal by an appellate

court is an adjudication *only of matters expressly discussed and decided \* \* \*.*" To the same effect *McLain Lines v. The Ann Marie Tracy*, 176 F. (2) 709, p. 711; *U. S. v. U. S. Smelting Co.*, 339 U. S. 186, p. 198.

## C.

**The assertions in the Commission's Brief pages 12-14 that the contested issues on this appeal are confined to Petitioner's bile flow claims are without substance or support.**

**Furthermore, the Commission's findings on all the other issues in this case are equally contrary to the evidence and are further so intermingled with, and infected by, the invalidity of its findings on the issues of bile flow and constipation that they must likewise be set aside.**

Not only do Petitioner's Statement of Points (Vol. VIII, N. R., pp. 3540-3556) and its Petition For Review (Vol. VIII, N. R., pp. 3531-3539) bring up for review all the other issues in this case but, in addition, Petitioner's Designations, dated February 15, 1957, filed with this Court, themselves fairly and squarely contain the following plain notice to the Commission apprising it of that fact:

*"2... Petitioner begs leave to furnish the Court with 10 printed copies of the Petitioner's Original Printed Exceptions To The Trial Examiner's Original Report and its original printed Proposed Findings of Fact, all dated October 15, 1946, a printed copy of which was filed of record in the former proceedings (and copies of which have previously been furnished to the Respondent) for use on this review, in lieu of reprinting those exceptions and proposed findings; and Petitioner notifies the Respondent that it intends to rely on the matters and things of record and the excerpts from the testimony and transcript*

*set forth in those printed exceptions and proposed findings as further basis for its Petition to Review and Set Aside the Respondent's Cease and Desist Order.”\**

The reasons why the Commission is not entitled to have this Court sustain *any* of the provisions of its Order (see those specifically referred to, p. 14 of the Commission's Brief) and the supporting references to the testimony of Petitioner's witnesses, Drs. Avrack, Boyd, Colbert, Darling, Edlin, Leader, Lindauer, Lopez, Lyon, Steigmann, Whittemore, O'Brien, Allen, Bastedo, Johnson, Eller, Dorman, Sandford and Loewe which demonstrate the truth of *all* Petitioner's therapeutic and advertising claims are set forth at pages 3-5 and 9 of Petitioner's Original Printed Exceptions and at pages 143, 147-148, 191-196 of Petitioner's Original Proposed Findings of Fact, all dated October 15, 1946 (Vol. IX, N. R., at p. 3557) and at pages 170-201 of Petitioner's Original Brief, dated February 1, 1947, which is also a part of the transcript of proceedings filed with this Court, extra copies of which are available for its use.

It has been literally and physically impossible, because of space limitations, to give treatment to these other issues in Petitioner's Opening Brief and in this Reply Brief. The Court is therefore respectfully referred to the treatment at length of these other issues in the documents and brief referred to. From an examination of these documents, the truth of all of Petitioner's advertising claims will, Petitioner respectfully asserts, fully appear.

Furthermore concerning these assertions in the Commission's Brief (p. 14) to the effect that the Commission is entitled to a decree affirming all other findings of fact except

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\* See also pp. 9-10, Petitioner's Opening Brief.

those relating to Petitioner's bile flow claims, and that the Commission is also entitled specifically to a decree enforcing certain specified provisions of the Commission's Cease and Desist Order, there is a further simple answer. Those other Findings and those specific provisions of the Commission's Order, besides being contrary to the weight of evidence as shown by the evidence and documents referred to above, are also, as this Court will see by examining those provisions of the Order, so inextricably inter-related and intermingled with Petitioner's bile flow claims and the Petitioner's claims concerning the relationship between constipation and bile flow that those other Findings and provisions of the Order must also of necessity likewise fall with the falling and setting aside of the Commission's Findings and the provisions of its Order concerning these basic bile flow and constipation claims of the Petitioner.

Subdivision (1) of the Commission's Order (Vol. I, N. R., p. 312) which forbids advertising "That constipation poisons the body" is in effect in virtual conflict with the logic of the testimony of the Commission's own witness, Dr. Carlson, whom the Commission's Brief (p. 29) describes as "one of the greatest physiologists in the world." This witness for the Commission, though obviously equivocating as to constipation's being poisonous, flatly asserted, however (Vol. I, N. R. Carlson, p. 388), that constipation was a disease and "that constipation can be so chronic and the absorption of water from the fecal material so great, it becomes dry, and in the end *causes local ulcers and local sores and lesions and bleeding \* \* \**" and (Vol. I, O. R. 379, Carlson) that if "digestible and unabsorbed food have gotten down into the large bowel and stayed there because of *constipation*, there would be some *bacterial action on it*"—deleterious effects which are cer-

tainly at least comparable to poisoning the body.\* The Commission's notion that constipation does not result in the growth of the poisons—phenol, indol, or skatol—(Vol. IV, O. R. 1418-19, Bollman; Vol. VI, N. R. 2494, Bollman) is further derived from the dog experiments of Bollman whose hopelessly vitiating defects have been shown. In fact Bollman conceded (Vol. IV, O. R. 1452) that an ingredient of his diet for these dogs had a protective action against these very poisons. This is but one instance of the futility of trying to separate the void and partly void intermixture of findings which the Commission has made in this case. Excluded by the Commission in this connection is the pertinent statement contained in Petitioner's Offer of Proof (Vol. I, N. R. p. 64) of Dr. John A. Wolfer that "*Constipation* may predispose an individual to gallstone formation because of *intestinal infection* and secondary cholecystic disease. Kraus reported that 80% of patients with gallstone were constipated"—a statement again indicative of an effect comparable to poisoning the body.

Subd. (h) of the Order (Vol. I, N. R., p. 312) forbids advertising "That said preparation will cause the proper flow of, or beneficially affect, the gastric juices or digestive juices." Here again, despite equivocations on his part, the Commission's witness, Dr. Ivy, nevertheless, testified (Vol. II, O. R. Ivy 538-539) that Carter's Little Liver Pills would increase the volume of the most important digestive juice, increase the bulk in the small intestine, increase the peristaltic movements, etc. (*id.* 539). *It is true that Ivy also claimed that this admitted action of the pills was not in his opinion beneficial. However,* the credibility evaluations made by the Commision have been shown to have been

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\* See also the uncontradicted testimony of Petitioner's witness, Dr. McGuigan (Vol. III, N. R. 882), ignored by the Commission in its Findings, that constipation may cause "ulceration", "inflammation", "hernia", or "even cause angina pectoris or apoplexy by straining".

so deficient and Ivy's testimony and experiments have been shown to have been so defective and untrustworthy that there is no reason to trust Ivy's attempts to discredit the beneficial nature of this admitted effect of Petitioner's product. Further, here again, the Commission neither took proper note of the testimony of the Petitioner's witnesses, Drs. Crandall (N. R. Vol. VII, 2898-2900) and McGuigan (N. R. Vol. II, 833-871; N. R. Vol. III, 938-9) as to the value of cathartics and laxatives and their safety, nor of the testimony to that effect of Petitioner's witnesses, Drs. Avrak, Boyd, Colbert, Darling, Edlin, Leader, Lindauer, Lopez, Lyons, Steigmann, Whittemore, O'Brien, Allen, Bastedo, Johnson, Eller, Dorman, Sanford and Loewe, supporting references to whose testimony in the original transcript certified to and on file with this Court are set forth at pages 3, 5, 9 of Petitioner's Original Printed Exceptions, dated October 15, 1946, and at pages 143, 147-148, 191-196 of Petitioner's Original Proposed Findings of Fact dated October 15, 1946 (N. R. Vol. IX at p. 3557) and in Petitioner's Original Brief, pp. 170-201, filed with the Commission.

Subd. (d) of the Commission's Order (*id.* 312) forbids advertising "That said preparation is unqualifiedly safe". Of course, as appears from Petitioner's Original Proposed Findings p. 196, Petitioner has included in its labeling for years the following statement:

"Important Warning—In cases of symptoms of appendicitis such as vomiting, severe abdominal pains or nausea, do not take Carter's Little Liver Pills or any laxative. See your physician. Carter's Little Liver Pills are to be taken only as needed and should not be used habitually."\*

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\* See also Petitioner's Opening Brief, p. 106, and Commission's Ex. 1-B there referred to, for similar *qualifications* in Petitioner's directions for use of its product.

There has thus never been a claim by Petitioner that its product is “*unqualifiedly safe*”.

The other specific provisions of the Order to which the Commission here makes reference (its Brief, p. 14) are, as this Court will see by examining them, too obviously interrelated with Petitioner’s bile flow and constipation claims and the Commission’s invalid Findings concerning these claims to require discussion.

In general, as was to be expected from the Petitioner’s showing of the Commission’s bias and denials of due process in connection with its treatment of Petitioner’s bile flow and constipation claims, the Commission likewise *applied* (as this Court will see by examining the record references cited above and their discussion in Petitioner’s Original Brief of Feb. 1, 1947) the *same* disqualifying fixed prejudgment and *similarly* biased treatment to all these *other* issues.

## D.

### Conclusion.

On all the grounds set forth in Petitioner’s Opening Brief and in this Reply Brief and Appendix and because of the Commission’s flouting of the spirit and purpose of this Court’s remand,\* Petitioner respectfully requests that this Court reverse and set aside the Commission’s Order in its entirety and thereby put an end to the fourteen long years of harassment and expense and to the unjust and adverse publicity to which Petitioner and its product have been subjected and also to the public waste caused by this ill-starred

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\* “after the remand was made therefor the Commission was bound to deal with the problem afresh”, *Securities Commission v. Chenergy Corp.*, 332 U. S. 194, p. 201.

and senseless litigation which, to use the words of Judge Medina in *Prima Products Inc. v. Federal Trade Commission*, 209 F. (2d) 405, p. 406, now "bears a marked resemblance to the proverbial tempest in a teapot."

Dated: December 6, 1957

WILLIAM L. HANAWAY,  
STODDARD B. COLBY,  
HERMAN PHLEGER,  
ALVIN J. ROCKWELL,  
Attorneys for Petitioner.

BREED, ABBOTT & MORGAN,  
BROBECK, PHLEGER & HARRISON,  
Of Counsel.

## APPENDIX A.

### **Material Misstatements, Omissions and Distortions Contained in the Commission's Brief Refuted, and Further Instances Demonstrated of the Commission's Denials of Due Process.**

1. At the risk of creating the possible impression in the mind of this Court that the use of podophyllum (one of the ingredients of Petitioner's pills) is officially wholly disapproved, the Commission (Commission's Brief, p. 15) asserts that "Podophyllum has been removed from the U. S. Pharmacopeia". The Commission well knows, and this Court may take judicial notice of the fact,\* suppressed by the Commission's Brief, that podophyllum was officially reinstated to the U. S. Pharmacopeia and now appears in the Fifteenth Revision at p. 560 of that official compendium as of December 15, 1955.

2. The Commission asserts (Commission's Brief p. 16) "if there is an impairment or a disease of the liver which *cuts the production of bile*\*\* to 80% there still *would remain* sufficient bile for the proper digestion of fat food (R. 12940, Vol. IV, 1417-18, 1478)". This reference is to testimony of the Commission's witness, Bollman. What Bollman actually said was absurd enough, i.e.:

"Q. Doctor, in your opinion, to what extent may the human liver be damaged and still produce sufficient bile to carry on the functions of bile in the process of human digestion? A. I should say that somewhere around eighty percent of the liver could be absent or severely damaged and yet the liver maintain sufficient bile output to carry out the process of digestion" (Bollman, O. R. Vol. IV, p. 1417).

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\* See authorities, p. 31 of Petitioner's Opening Brief and, *infra*, end of this Appendix.

\*\* Italics ours throughout, unless otherwise noted.

Bollman did not, however, say, what is quite a different matter, i.e., that *production of bile itself may be reduced by that percentage*. This is clear from Bollman's explanation (Bollman, *id.* p. 1417) that "If part of the liver was removed, there is a *new growth in the remaining liver, so that there is essentially a replacement thereby, overcoming the lack of function that may have been implied in the removal of part of the liver*".

More serious is the Commission's omission of all reference in its Brief to the following flat denial of due process committed by the Commission through its Examiner. By this denial of due process, Petitioner was deprived of its clear right to *rebut* Bollman's testimony, by showing through Petitioner's own witness, Dr. Morrison, that no human being had ever been known to function normally with 80 % of his liver absent or severely damaged.

The Commission's Examiner thwarted all legitimate inquiry of Dr. Morrison by Petitioner in this vital area, as follows (Morrison Vol. IV, N. R. 1601-1602):

"By Mr. Hanaway:

"Q. Do you know of any cases, ambulatory cases of individuals whose livers are defective to the extent of 80 per cent?

"Mr. Cohn: Objection.

"Trial Examiner Purcell: I believe it is proper redirect.

"Mr. Hanaway: Because Mr. Cohn asked him on cross about the possibility of liver disorder or incapacity to the extent of 80 per cent.

"Trial Examiner Purcell: You are now seeking to elicit the Doctor's knowledge as to ambulatory cases.

"Mr. Hanaway: With livers. I want to know if there is anybody who has a liver which has been destroyed to the extent of 80 per cent, who is not a museum piece or a monstrosity of some kind.

"Mr. Cohn: Of course, if your Honor please, I made special emphasis on what the Doctor knows.

"Mr. Hanaway: Are these hypothetical questions or are there actual persons walking around whose livers are not there? In other words, the question is of no importance on cross examination.

"Trial Examiner Purcell: Let us have the question.

(The question referred to was read by the reporter, as follows:

"Q. Do you know of any cases, ambulatory cases of individuals whose livers are defective to the extent of 80 per cent?"")

"Mr. Cohn: Objection.

"Trial Examiner Purcell: Objection sustained.

"Mr. Hanaway: May I ask your Honor's basis for that."

"Trial Examiner Purcell: In the first place, the Doctor has stated that there is no way that he can ascertain the percentage of damage incurred in any particular liver, even by functional tests. *I apprehend* that the only way he could ascertain that would be by biopsy and histological examination.

"Mr. Hanaway: I would like to have the witness testify.

"Trial Examiner Purcell: You asked for my reason.

"Mr. Hanaway: I would like to have the witness testify.

"Trial Examiner Purcell: I have given my reasons and I sustain the objection. \* \* \*"

*No further comment is necessary!*

The right of rebuttal is a fundamental constitutional right. Its denial is a denial of due process. Admission of rebuttal evidence is *not* a matter of discretion; it is a matter "of strict right," *Throckmorton v. Holt*, 180 U. S. 552, 565. Its denial is reversible error. As a matter of constitutional

right a party must be given an opportunity "to offer evidence in *explanation or rebuttal*," *Int. Com. Commission v. Louisville & Nashville R. R. Co.*, 227 U. S. 88 page 93; *Ankersmit v. Tuck*, 114 N. Y. 51 page 55. This applies to all of the other incidents of similar refusals by the Commission of Petitioner's right of rebuttal or *explanation* set out in this Reply Brief and in Petitioner's Opening Brief.

Again, in this connection, no reference is made in the Commission's Brief to its and its Examiner's erroneous rejection of Petitioner's Offer of Proof (Vol. I N. R. p. 44) of the statement in Dr. Twiss's\* article, page 194, (Petitioner Ex. for Id. No. 3), in rebuttal in general of Bollman and other witnesses of the Commission, that "Results obtained in healthy *ambulatory* patients are preferable to those obtained in sick bed patients, particularly those recently subjected to operative procedures involving alterations in the biliary duct."

3. The Commission states (Brief, p. 16) "an individual does not require the production of two pints of bile daily to prevent digestive disturbances (R., 12940, Vol. II, 671-674, 1557)." Again, what the Commission fails to disclose to this Court is that its own witness, Dr. Walter Lincoln Palmer (Palmer, Vol. II, N. R., 646-647), whose formidable list of qualifications consumes some two pages of the Examiner's Original Report (O. R., Vol I, pp. 283-4), on reading the statement from Petitioner's advertising as to the liver that, "its job is to pour two pints of bile juices a day into your bowels, to help digest your food, to help in stopping its unnatural decay and to help your bowels to move softly, naturally, fully", answered (N. R., Vol. II, pp. 646-648), "*That is, in the main, true*". Again, on reading Petitioner's advertising statement that (*id.* 648) "the liver should pour out two pounds of liquid bile on to the food you swallow each day," the Commission's

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\* Dr. Twiss's authoritativeness was recognized by the Commission's witness, Bollman, on the remand (Vol. VIII, N. R. 3223; Petitioner's Opening Brief, pp. 73, 75-6).

witness, Dr. Palmer also answered "*That is approximately correct*".\*

4. The Commission states (Brief, p. 16) :

"We believe it is equally important to invite the Court's attention to the *fact* that there is no evidence of *any nature* in the record that *any doctor has ever prescribed* petitioner's laxative pill for any purpose other than to produce an evacuation of the bowels."

Of course, the actual fact is that Petitioner's witness, Dr. Morrison, (Morrison, Vol. IV, N. R., 1600-1601) testified on redirect:

"By Mr. Hanaway:

"Q. You stated during cross-examination that Carter's Little Liver Pills were not a primary treatment for *biliary dyskinesia*. What did you mean by that? A. I meant that the drug was not used primarily in this condition, but that it might have a therapeutic effect if used when *this condition was associated with chronic constipation*.

"Q. *Is it frequently association (sic) with chronic constipation?* A. I believe it is.

"Q. Do you use aloes and podophyllum as routine *stimulants* in biliary drainage in your office? A. I do now".

Even the Commission's witness, Dr. Palmer, when asked by the Commission's Counsel whether he had "ever heard of a doctor using aloes and podophyllum, Carter's Little Liver Pills, for the purpose of increasing the flow of bile", answered: "I have heard of them doing it, yes, they think they do it" (Palmer, Vol. II, O. R., 696).

That there is not a great deal more evidence in this record of the prescription by eminent doctors of aloes and podophyllum, the ingredients of Carter's Little Liver Pills,

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\* Medicine as an inductive science is itself "a field of knowledge where even experts must be content with *approximations to verity*"; *Scientific Mfg. Co. v. F. T. C.*, 124 F. (2) 640 p. 644.

and of the therapeutic value of those drugs in increasing bile flow is due to the fact (which again the Commission in its Brief omits to state) that its Examiner and the Commission also excluded, among other things, the following:

Statements by Dr. Martin Rehfuss, recognized as an authority on the subject by Commission's witness, Bollman (Bollman, Vol. VIII, N. R. 3212) in Dr. Rehfuss' authoritative book, with which Bollman swore he was familiar, (*id.* 3212), "The Medical Treatment of Gallbladder Disease", Chapter XVI (Petitioner's Exs. 8 and 9, for *Id.* appended to its Offer of Proof, Vol. I, N. R. pp. 46, 47, 54, 61) specifically attesting to the therapeutic value and use of podophyllum as a vegetable chologogue (p. 289):\*

"The so-called 'vegetable' cholagogues include many substances, *aloes*, *podophyllin*, boldo, enonymin, frequently found in laxative and cathartic pills. \* \* \* *Podophyllin* is part podophyllotoxin and part picropodophyllin. *Its action is to empty the liver radicles and fill the biliary passages.* \* \* \* We have used all these substances \* \* \*."

This was not one of the texts as to which Petitioner was permitted actually to cross examine Bollman. It was an authority discovered thereafter, but while the proceedings were still open, and it was as aforesaid included in Petitioner's rejected Offer of Proof\*\* made in accordance with Petitioner's arrangement with the Examiner.

5. Four pages of the Commission's Brief (pp. 17-20) are devoted to maligning Petitioner for making what Petitioner asserts is, on the contrary, an obviously true interpretation of the effect of the testimony of the Commission's witnesses, Ivy and Carlson. The plain fact is, despite the Commission's attempts at palliation, that Ivy published an article with regard to the common duct fistula method, a method which Ivy used in his abnormal dog experiments (whose description by the Examiner is

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\* See p. 290, same Ex. for *Id.* prescribing podophyllum.

\*\* Vol. I, N. R., pp. 46, 47, 54, 61.

set out in Petitioner's Opening Brief, pps. 13-14), in which Ivy said (Vol. II, N. R. 683-5) that with a duodenal or common duct fistula "the physical conditions are *entirely changed, a fact that has been disregarded too frequently*" and conceded on cross examination that it creates "a disturbance and (sic) of possible creation of *abnormal* difference in pressure." (*id.* 684-5).

That the Commission's charges against Petitioner in this regard are without any real substance and that the surgical fistula methods used by Commission's witness Ivy did in fact create an *abnormal* condition as Petitioner maintains they did, are proved out of Ivy's own words quoted by the Commission itself (Commission's Brief, p. 31), "Dr. Ivy explained", says the Commission, "that bile *normally flows into our intestines, and in the experiment in Table I (CX97) there was no bile in the intestine \*\*\**". Of course, there was no bile *flowing into the intestines in Ivy's fistula experiments*, as Ivy himself testified was the *normal and proper way for bile to flow*, because, with a surgical fistula, bile is cut off and diverted (into a bag or cylinder where it is collected) from its normal course of flow into the intestines *which it never reaches*. The Examiner in effect so states in his description of Ivy's fistula method (Paragraph 106, Examiner's Original Report, p. 98, Vol. I, O. R.).

Obviously, also, it is the general gist of the Commission's witness, Carlson's testimony (and that is all that Petitioner intended in its opening Brief to imply) that where the bile "*does not get into the intestine in the normal way*" it has "*a bad effect in the way of injuring the liver*" (Carlson Vol. I, N. R. 344-5). As the Court will see, it is eminently reasonable to apply that testimony of Carlson's to the abnormal situation created by Ivy in his surgical bile fistula dog experiments.

In this connection, here again, no reference is made by the Commission in its Brief to the testimony (confirmatory of Petitioner's interpretation) of Petitioner's witness, Dr. Morrison (Petitioner's Opening Brief, footnote p. 15 and pp. 138-139) as to the disturbing factor of surgical opera-

tions on the biliary tract which are present in the case of bile fistulas. Neither is there reference in the Commission's Brief to the authoritative statements contained in the article, which article is referred to in Dr. Twiss' affidavit (Vol. I, N. R. p. 59), *co-authored by Drs. Snell and Butt, Dr. Bollman's former associates at Mayo Clinic* (Bollman, Vol. VIII, N. R. 3175), being Petitioner's Ex. for Id. No. 13 p. 19 appended to Petitioner's Offer of Proof excluded by both Examiner and Commission. Those statements, indicative of the abnormal effect of bile fistulas, are that "The exclusion of bile from the intestinal tract *results in incomplete digestion and absorption* of fats and probably in some deficiency in the absorption of fat-soluble vitamins and calcium". Neither is there any reference in the Commission's Brief to the statement of the same Dr. Martin Rehfuss who was recognized by Bollman as authoritative (a statement likewise so excluded by the Commission and Examiner) in his "A Study of the Third Bile Fraction" Vol. 8, American Journal of Digestive Diseases, Nov. 1941, pp. 407-415, Petitioner's Ex. for Id. No. 7, p. 410, regarding studies "made on fistula bile which can hardly be considered normal". Again these were not textual authorities as to which Petitioner was permitted to cross examine Bollman, but again they were discovered thereafter but while the proceedings were still pending, and were also included in Petitioner's rejected Offer of Proof.

It is further a matter of plain fact and common sense, that these surgical procedures of Ivy's—particularly when all the other disturbing variables discussed in Petitioner's Point I, pp. 13-44 of its Opening Brief are also considered—obviously upset these test animals' metabolisms and nullified the Commission's tests just as Judge Woolsey held that the government's tests were nullified in *U. S. v. 59 Tubes*, 32 F. S. 958 (Petitioner's Opening Brief, pp. 14, 33, 43, 92, 150, 154, 161, 163), despite the Commission's unsupported protests to the contrary in its Brief.

6. The diatribe in the Commission's Brief (Commission's Brief, p. 21) directed against the Petitioner's assertion that Commission's witness, Dr. Carlson, swore *in effect*

that all the various units of the biliary system must be operating normally\* in order for the experiments to be valid, is camouflage. Carlson testified (Vol. I, N. R. Carlson 372) that bile acids "play a role in the *emulsification* of the fats in the food, which favors *digestion* of fats, possibly *inactivation of the enzymes in the pancreatic juices, digesting* the fat, possibly in *combining* with the *end products* of fat digestion, in favoring *absorption.*" Carlson was then further asked (Vol. I, N. R. 374 Carlson) "*What are the principal juices?*" And answered (*id.* 374) "Saliva, gastric juice, *bile*, pancreatic juice, succus entericus, or intestinal juice". In other words, Carlson included *bile* as one of the *principal juices*. Then, under further examination, Dr. Carlson let the cat out of the bag when he admitted (Vol. I, N. R. 375 Carlson) in answer to the question "*What about bile, in comparison with the other juices?*", that bile "*is important in the digestion and absorption of facts, and we don't do well in the total absence of bile from the intestine, but one would be fair in saying that all these juices are natural juices, and we are better off if we have all of them, in the average, normal amounts!*"

Obviously, since, as the Commission's witness, Carlson, was obliged to concede, we are *better off if we have all of these juices, including bile, in the average, normal amounts,* the answer that Carlson gave in response to the question of Petitioner's counsel (set out p. 21 of the Commission's Brief) was actually evasive\* and susceptible, on the other hand, to the precise interpretation given to it by Petitioner in its Opening Brief (p. 15).

All this Court need therefore do is to take the concession (above noted) of Commission's witness, Dr. Palmer, of the truth in the main of Petitioner's advertisement that the liver *should* pour two pints of bile juices a day into the intestines—i.e., that this is the daily required normal output of bile—and add to that concession the further concession of the Commission's key witness, Dr. Carlson (whom the Commission's Brief p. 29 calls "one of the greatest physiologists in the world") *that we are better*

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\* Vol. II, O. R., Carlson, 481-484.

*off if we have all these juices, including bile juices, in average, normal amounts,* in order for this Court to see at once that the Commission's attempt to have this Court believe the various irresponsible and exaggerated statements of some of the Commission's witnesses to the effect that bile flow can be radically diminished or practically eliminated without harmful results, is, to put it mildly, pure physiological nonsense.

7. By a series of elaborate omissions, the Commission, p. 22 of its Brief, next seeks to create two erroneous impressions, first that its witness, Ivy, satisfactorily explained away *all* the great variety of repeated contradictory statements in his own prior printed publications, made before he performed the experiments in suit, which published statements flatly and squarely—and this Petitioner asserts *truly*—set forth Ivy's really mature and deliberate scientific opinion that there *is* a causal relation between constipation and decreased flow of bile and, second, that there is some kind of impropriety on Petitioner's part either in claiming that Ivy published such views or failed to explain them away. Here, again, the Commission selects for its purpose *some but not all* of Ivy's publications, omitting reference to the others set out in Petitioner's Opening Brief, pp. 69-70\* also written by Ivy, in which he made similar public statements of his view that constipation and decreased bile flow are causally inter related.

Again, all that this Court need do, is to read the article by Ivy (which plainly speaks for itself) set out at p. 69 of Petitioner's Opening Brief and its interpretation by Petitioner's witness, Dr. Crandall, set out at p. 78 of Petitioner's Opening Brief and confirmed by Petitioner's witness Dr. McGuigan (Vol. II, N. R. 867-8; Vol. III, N. R. 901-910), in order for this Court to see that the Petitioner is correct both in its interpretation of the article and in its assertion that Ivy never satisfactorily explained it away.

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\* Through a typographical error Petitioner's Opening Brief, at that point, refers to these other articles as appearing in the testimony of Ivy instead of Bollman. The correct references are (Bollman, Vol. VIII, N. R. 3190, 3202 and 3205).

The Commission (its Brief, p. 22) makes partial quotations from Ivy's so-called explanation of one of his articles dealing with dog experiments. The Commission omits the following vital prefatory part of Ivy's testimony (Ivy Vol. II, O. R., 709) preceding the Commission's quotation, i. e. "That if you have an adequate flow of bile, adequate formation of bile by the liver, being formed in response to good stimulus then this reflex inhibition of bile—inhibitory influence on bile—is not adequate to stop the formation of bile". What Ivy thus was really saying was in effect (if one paraphrases that statement and applies it to Petitioner's claims) that if there is an adequate flow of bile (and by necessary supposition there is not such a flow of bile in persons for whom Carter's Little Liver Pills are sold i. e. as a laxative "aiding bile flow" and "not for diseases of the liver except those helped by better bile flow," Commission's Ex. 1A) and that if, in addition, you administer a "good stimulus" to bile flow (and the ingredients, aloes and podophyllum, in Petitioner's product, as Petitioner has shown, are just that) then and only then will the inhibitory effects in decreasing bile flow be overcome.

How palpably unsatisfactory were Ivy's attempts to explain away his prior contradictory published statements will be clear to this Court on reading Ivy's full testimony (Vol. II, O. R., 707-715). As just one example of Ivy's equivocations, on direct examination Ivy said (Ivy, Vol. II, O. R., 705): "You can divert the bile from the intestine of dogs and human beings without getting constipation or without constipation occurring" and almost in the next breath, on cross examination, (*id.* 714) "Dr. Ivy, would a lack of bile contribute to constipation or have a tendency to cause constipation?", "A. Yes, it would be called a predisposing factor, a complete lack of bile."

Entirely unexplained away by Ivy, are Ivy's published statements (Bollman, Vol. VIII, N. R., 3190 that (i) "Clinical evidence indicates that constipation and bowel spasm contribute to stasis or malfunction of the biliary tract" and (Bollman Vol. VIII, N. R. 3205) (ii) "Summarizing our data demonstrate that constipation and sluggish gall

bladder evacuation are related'', and, (iii) that (*id.* Vol. VIII, 3205) "It was found that in the case of both sexes the trend toward a correlation between constipation and incomplete gall bladder evacuation was present in all age groups." With these latter two statements of Ivy's, which amply confirm Petitioner's basic contention as to the causal relationship between constipation and decreased bile flow in humans, the Commission's witness, Bollman (Bollman Vol. VIII, N. R., 3205-6), on remand, *in general agreed!* Suppressed entirely both in the Commission's Brief and in its Findings also is all reference to the testimony of Petitioner's witness Dr. McGuigan (Vol. II, N. R., pp. 839-841) supporting the truth of Petitioner's claim of a causal relationship between constipation and supporting the authoritativeness of the article of Dr. Gauss, and by the same token, Dr. Lichtman, by which latter the Commission's witness, Dr. Bollman, was in effect discredited (Petitioner's Opening Brief pp. 70-72; pp. 77-78).\*

In Ivy's published article (Ivy, Vol. II, O. R., 710) concerning certain of his previous *dog* experiments, Ivy wrote:

"The results of these experiments provide two mechanisms by which *constipation* may *promote* gall bladder or biliary tract stasis. *Although* they tend to confirm *clinical* impressions and observations, *they cannot be directly applied to man*. They are sufficiently decisive and important to indicate *prophylactic therapy* and to stimulate research to ascertain whether such mechanisms actually operate in man. There is no *a priori* reason to doubt their existence in man."

These published statements of the Commission's witness, Ivy demonstrate conclusively the truth of Petitioner's contentions (Petitioner's Opening Brief, pp. 25-33), supported by the statements of the Commission's own witnesses

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\* See the overwhelming demonstration (ignored by the Commission in its Findings) by Petitioner's witness, Dr. McGuigan, (Vol. II, N. R. 838-849; 863-869) that "the consensus of the enlightened modern members of the medical profession" supports the *causal relationship* between constipation and bile flow.

and all the other evidence collected at that point in Petitioner's Brief, *that without adequate supplementary experimentation on human beings the Commission's animal tests were not translatable to man.*\* In fact when this precise same published statement of the Commission's witness, Ivy, was read to the Commission's witness, Bollman, on remand, (Bollman, Vol. VIII, N. R., 3202-3203), Bollman was asked by Petitioner's Counsel "*Did you understand that?*" "*A. Yes.*" "*Q. Do you agree with that?*" "*A. Yes.*".

The evidence overwhelmingly demonstrates (1) that in reality the views of the Commission's own witnesses themselves *actually tend to confirm* Petitioner's basic claim of a causal connection between constipation and decreased bile flow, and likewise tend to confirm Petitioner's assertions of the untranslatability of the Commission's animal experiments to man, and, (2), (Bollman Vol. VIII, N. R., 3179-3206; 3378-3386), at the very *minimum*, present the kind of uncertainty and lack of "*general medical agreement*"\*\* which under Point III of Petitioner's Opening Brief is sufficient in itself for the reasons there stated to vitiate the Commission's present order. There was no intention in the Act that the Commission should "*become the absolute arbiter of the truth* \*\*\*", even where scholars in the particular field of knowledge were in wide disagreement"; *Scientific Mfg. Co. v. F. T. C.*, 124 F. (2) 640, p. 644.

8. There follows here (Commission's Brief, bottom of p. 22 and first paragraph top of p. 23) another series of misstatements by the Commission, the complete answer to

\* See the many further authoritative textual statements, in support of this proposition, of Dr. O. H. Horrall (Petitioner's Brief dated November 29, 1955 on Appeal to the Commission, pp. 32-34) recognized as an authority by Commission's witnesses, Carlson (Vol. I, O. R. 466-7; 493; Vol. II, N. R. 450-1) and Bollman (Vol. VIII, N. R. 3227-8).

\*\* See also the testimony of the Commission's own witness, Dr. Palmer, ignored by the Commission in its Findings (Palmer, Vol. II, N. R. 651-653), as to the "*difference of medical opinion*" on certain conditions improved by better bile flow, and, it seems, a great deal of difference of opinion on various issues involving the biliary system, full cross examination as to which was blocked by the Commission's Examiner (Palmer, Vol. II, N. R. 653).

which, with supporting record references has already been furnished at pp. 24-25, 39-40 and 137-139 of Petitioner's Opening Brief. There in detail the truth is made clear of Petitioner's assertions that the Commission's witness Ivy's own testimony, actions and procedures demonstrated, out of his own mouth, that reliable quantitative results are actually obtainable by the use of the duodenal drainage method employed by Petitioner's witnesses which method was erroneously discredited by the Commission through its bias and pre-judgment of this case. To the arguments and record references squarely supporting the validity of the duodenal drainage method used by Petitioner's witnesses set out at that point in Petitioner's Opening Brief, should also be added the testimony of the Commission's witness, Ivy, (O. R., Vol. IV, pp. 1536-1537, Ivy) that such method "is always reliable when you use a potent stimulant", which is precisely what Petitioner claims, and the record shows, aloes and podophyllum are. *And, of course, there should also be added the wealth of scientific authority supporting that method, as to which Bollman was not cross examined, but which was timely offered by Petitioner and rejected by the Examiner while the proceedings were still pending before him, in which rejection he was sustained by the Commission on appeal.* Because space does not permit of adequate presentation here, the Court is earnestly requested to read the discussion of the Commission's and the Examiner's reversible error in rejecting in this respect this Offer of Proof at pps. 16-19 of Petitioner's Brief (dated Nov. 29, 1955) on Appeal to the Commission and pps. 7-8 of Petitioner's Supplemental Brief (dated May 11, 1956) on Appeal to the Commission. These Briefs are a part of the record certified to this Court, extra copies of which have been furnished to it.

9. Next, p. 23 of the Commission's Brief, the Commission makes the completely unfounded charge that "Perhaps one of the worst examples of distortion indulged in by petitioner in its brief appears on page 150 \* \* \*", concerning Bollman's testimony.

If the Court will carefully examine the Petitioner's statements at pp. 149-150 of its Opening Brief, and the

full context of Bollman's testimony commencing p. 2569 and ending p. 2577, Vol. VI, N. R., and, Bollman's testimony, bottom of p. 1495 through 1496, Vol. IV, O. R., three things will be apparent to the Court: (1) the correctness of Petitioner's interpretation of Bollman's testimony or writings and those of other witnesses concerning the lack of sufficient sensitivity of liver function tests in general, either as an adequate measure of normal bile function, or as a means of accurately gauging or assaying increases in bile flow such as are produced by Petitioner's product or by other accepted products commercially used to increase the flow of bile, (2) the correctness of Petitioner's interpretation of the testimony of Bollman, and (3) the lack of justification for the Commission's unwarranted assault on Petitioner's statements.

This Court will incidentally glean from an examination of this testimony of Bollman's (N. R., Vol. VI, pp. 2569 through 2577) two other things, first, a typical example (though comparatively mild) of which there are literally hundreds of others in this vast 11,000 page record, of the kind of harassing and thwarting tactics of the Commission's Counsel\* which beset Petitioner in the conduct of its defense at every step throughout this entire litigation and, second, further confirmation (see Petitioner's Opening Brief, pp. 98-99) of the fantastic farce of Bollman's *gross* post-mortem inspection of the livers of his three dogs "after", as this Court said in its prior opinion in this case, 201 F. (2) 446 at p. 450, "varying degrees of post-mortem degeneration had taken place." Bollman made nothing but a *gross* examination—and not, of course, a microscopic one—and Bollman conceded (Bollman, N. R., Vol. VI, pp. 2576-7) that "at other times I would not be able to, or

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\* Eloquent evidence of the lengths to which Commission's Counsel went in hindering effective cross examination by Petitioner of the Commission's witnesses after the remand, is provided by the fact that even the Examiner himself rebuked Commission's Counsel for such tactics (Vol. VIII, N. R. p. 3291) and repeated that rebuke in his Supplementary Report (Vol. I, N. R. p. 194), saying "\*\*\*\* I have had to fight that very thing at almost every step of this proceeding since it has been reopened, because of your objections, and very frankly, Mr. Cohn, if I may use that colloquialism, I am getting fed up on it."

having drawn such conclusions from the *gross* examination *I would change them on the microscopic examination*, but I might be mistaken, because I say, you can only see what you can see". Bollman likewise confessed (*id.* pp. 2576-2577) that he had previously published an article, which he endorsed as still correct in which he gave it as his view that "The *gross* appearance of the liver, while useful in classifying livers as normal, chronically inflamed or definitely cirrhotic, did not give accurate information with regard to the degree of physiologic change which was associated with the pathological findings."

No further comment is necessary.

10. Next (Commission's Brief, pp. 28-29) under the heading "Petitioner's Laxative Pill Will Have No Effect Upon the Formation or Flow of Bile", the Commission, as a kind of last resort, appeals generally to the alleged eminence of its expert witnesses, ignoring the obvious fact that eminence and reputation are neither substitutes for proof nor guarantees against bias, for, as the Court held, in *Chandler v. Mock*, 150 F. (2) 563 p. 567, an expert's "reputation cannot be utilized to cover a deficiency in evidence."

11. Next (Commission's Brief, pp. 30-33) comes a discussion by the Commission entitled "Experiments Performed by Dr. Ivy To Determine If Petitioner's Laxative Pill Will Have Any Effect Upon The Formation of Bile by The Liver".

There is here no attempt to answer the irrefutable evidence emanating from the Commission's own witnesses (ignored by the Commission through its bias and prejudgment of the issues in this case) which, on the face of things and self-evidently, invalidated these experiments (Petitioner's Opening Brief, pp. 13-44). Neither is there here any attempt to justify the plain denial of due process committed by the Commission through its Examiner (Petitioner's Opening Brief, pp. 18-19) in foreclosing proper cross examination of the Commission's witness, Ivy, by Petitioner in order to demonstrate through him that by his addition, for six whole days, of enormous extra doses of

of artificial bile salts, the test animals, on Ivy's virtual admissions, had already reached the peak of their ability to put out any further bile in response to the administration, on top of these bile salt, of doses of Petitioner's product.\*

Further the Commission fails here to point out to the Court that the experiments here discussed, which dealt with the *formation of bile* by the liver, were, of course, as a further condemnation of them, *totally irresponsible* to Petitioner's basic claim that its product is "a laxative aiding bile flow", "not for diseases of the liver except those helped by a better bile flow" (Commission's Ex. 1-A). Such experiments were therefore utterly inapposite to Petitioner's claim of the *cholagogic* effect of its product. A cholagogue is a substance (Examiner's Report, O. R., Vol. I, p. 80) "which increases the *flow of bile into the intestine*, as, for example, by facilitating gall bladder evacuation", while, on the other hand, (Examiner's Report, *id.*) a "*Choleretic* is a substance which increases the *formation of bile by the liver*." Again no further comment is necessary.

12. The Commission (its Brief, bottom p. 33) quotes Petitioner's witness, Dr. Crandall, as testifying "that he did not think constipation under any circumstances decreased the flow of bile to such an extent as to *affect* the digestive process". The record contains no such testimony, and this plain misconstruction further omits to quote Dr. Crandall's testimony (Vol. VII, N. R., 2919):

"Q. Doctor, is it your opinion that functional constipation in any form *injures* the liver insofar as its secretion of bile is concerned? A. I have no *fixed* opinion on that subject, but *I am inclined to believe what you say possible.*" \* \* \* "That is to say, I think it is *entirely reasonable on the basis of the evidence we have to think that functional constipation may decrease the flow of bile.*"

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\* Denial of this basic constitutional right of cross examination of Ivy on this material and vital issue is both reversible error and a denial of due process; *Alford v. U. S.*, 282 U. S. 687, pp. 691-2. "Cross examination of a witness is a matter of right, \* \* \* It is the essence of a fair trial \* \* \*". *Reilly v. Pinkus*, 338 U. S. 269, pp. 275, 276.

Commission's Counsel himself read into the record (Crandall, *id.*, 2919) Dr. Crandall's published statement that "Fat absorption is then not *entirely* dependent on the presence of bile, but must be greatly facilitated by *bile salts* since I have found and have previously reported to this Society that a fat meal does not cause the *usual* increase in blood fat when given to the *bile fistula dog*"—in other words, where (as before explained in this Brief), the bile is diverted from the dog's intestines, as, for example, in Ivy's dog fistula experiments. Also, similarly read into the record (Crandall, *id.* 2918) was another published statement by Dr. Crandall to the effect that although the human bile salts "are not *essential* for the splitting of fat to fatty acids and glycerol by the lipases of the pancreatic juice and intestinal secretion", "*they unquestionably accelerate that process.*" Obviously, in view of this testimony and these published statements of Petitioner's witness, Dr. Crandall, and the testimony of the Commission's witness, Dr. Carlson (*supra*) to the effect that "we are better off if we have *all* the natural juices (including bile salts) *in average normal amounts*", it follows as a matter of common sense that decreasing those juices below normal *affects* the normal functioning of bile salts and *affects* the normal functioning of the digestive system. That it does not actually *prevent altogether* the functioning of bile (Crandall Vol. IV, O. R., 1672) is obviously quite a different matter.

13. The discussions in the Commission's Brief, pp. 34-54, under the respective headings "Experiments Conducted by *Dr. Ivy* to Determine If Constipation Affects The Flow of Bile", "Experiments Conducted by *Dr. Bollman* To Determine If Constipation Affects The Flow of Bile", "Experiments Conducted by *Dr. Ivy* to Determine If Petitioner's Laxative Pill Will Have Any Effect Upon The Gall Bladder", "Experiments Conducted by *Dr. Case* To Determine If Petitioner's Laxative Pill Will Have Any Effect Upon The Gall Bladder" and "Petitioner's Laxative Pill Will Not Affect The Flow of Bile In Any Manner" simply make no serious attempt (in fact the Commission's Brief abandons any attempt whatsoever) to answer either the

specific, detailed, irrefutable showing of the hopeless, self-apparent vices in the Commission's experiments disclosed in Petitioner's Opening Brief pp. 10-44 and 66-105 or the violations of due process in connection therewith which the Commission committed throughout this case either itself or through its Examiner.

A footnote, p. 36 of the Commission's Brief, attempts to answer Petitioner's clearly justified objection to Bollman's bizarre dog tests as being further *totally unrepresentative* because they were performed on *only 3 dogs*. The Commission's statements there ignore the very same type of objection on Ivy's own part (Petitioner's Opening Brief, p. 100) i. e., that animal tests require "*the performance of a number of tests either on the same or on a group of different animals.*" The footnote also omits to state that the Commission's own witness, Dr. Carlson, voiced the same view as to the lack of the sufficiently representative character of tests performed on animals when he wrote in his book, "*The Machinery Of The Body*", regarding the danger of generalization of animal tests with drugs, "*Perhaps by accident the few dogs employed were not representative of dogs in general*"—another of the important authoritative scientific writings (in fact an admission by the witness himself) contained in Petitioner's Offer of Proof and erroneously excluded by both Examiner and Commission (See Vol. I, N. R. pp. 42-43 for full reference and quotation). For just such a cogent reason i. e., lack of a sufficiently representative character, Judge Woolsey condemned the government's tests as without "*juridical effect*" in *U. S. v. 59 Tubes etc.*, 32 F. S. 958, namely because of the untenable assumption "*that the test animals are all substantially identic in their reaction, metabolism*" p. 962.

As to the italicised portion of the statement by the Commission (p. 46 of its Brief) that "*After the effect of the above experiments on the dogs had worn off*, a second series of experiments were performed", no record reference supports this statement. It further appears that the animals were under the effects of anaesthesia (Ivy II O. R. 627, 630, 642 and Vol. II, N. R. 700). As to the short term experi-

ments, Ivy answered (Vol. II, N. R. Ivy 700) "In Exhibit 98, all of the animals were anesthetized." "*Q. All the time during the course of the experiment?*" "*A. Yes.*"

By way of further illustration of the kind of misstatement in which the Commission in its Brief (at this point and elsewhere) indulges, is the Commission's statement concerning Bollman (having reference to the unsavory incident in which Bollman attempted to discredit the method employed by Petitioner's witness, Dr. Morrison, and was caught in an untruth on cross-examination after remand) that Bollman (Commission's Brief, p. 38) "*himself did not make the statistical determination*". This Court is invited to read Bollman's testimony (p. 88 Petitioner's Opening Brief) concluding with the following question and answer by Bollman, showing the error of the Commission's statement in its Brief:

"*Q. You did not do the statistical analysis of Morrison data, but you did do the statistical analysis of your own data as set forth in three exhibits I have just mentioned? A. That is correct.*" (Bollman, Vol. VIII, N. R. pp. 3365-6).

Despite the especially heavy affirmative burden of proof which the circumstances imposed upon the Commission in this case, none of its witnesses were professional statisticians and the Commission made no proper offer of proof by statistical experts of the statistical significance of its experiments. Dr. Ivy testified "I am not an expert in the field" (Vol. VII, N. R., Ivy, p. 2773). And yet, in demonstration of the necessity of statistical evaluation, the Commission's witness, Dr. Carlson, wrote, ("Machinery Of the Body") "Special mathematical techniques employed in statistics may be required to determine whether the difference observed in the experimental and controlled groups are probably significant or probably due to chance"—another authoritative scientific textual statement—again by a witness for the Commission—which the Examiner and the Commission wrongfully excluded (Vol. I, N. R., p. 45). This

vital insufficiency in the Commission's experimental proof is confirmed by the testimony of the Commission's witness. Dr. Bollman when on the original hearings he said that after certain preliminaries “\* \* \* I usually ask a statistician to determine the *significance* of the data which I supply him with *on a statistical basis*” (Vol. IV, O. R., Bollman p. 1486.)

14. The Commission's discussion (its Brief pp. 54-56) of the testimony and experiments of Petitioner's key witness, Dr. Killian, conveniently omits all reference to the following facts (Petitioner's Opening Brief, pp. 107-112) (a) that at the precise and crucial point where this witness for Petitioner was endeavoring to *explain*, supplement and interpret his experiments by legitimately expressing his expert opinion that Petitioner's product had the effect of increasing bile flow *not confined to the four conditions of his experiments*, he was abruptly blocked and shut off from completing the record on this point by the act of the Commission through its Examiner. *This was a flat denial on its part of constitutional due process\** to Petitioner and was made even more damaging and discriminatory by the fact—again omitted from the Commission's Brief—that the Commission through its Examiner (Petitioner's Opening Brief, pp. 112-113), with characteristic bias, compelled Petitioner's witness, Dr. Hazelton, on the other hand, to render opinions outside the scope of his experiments; (b) by the fact that the validity of Killian's experiments is fully documented and sustained at pages 66 through 120 of Petitioner's printed Brief dated February 1, 1947, filed with the Commission at the close of the original hearing, a printed copy of which is included in the record certified to this Court (to which the Court is respectfully referred) and (c) by the fact that there is no express Finding by the Commission that Petitioner's experimental proof including Killian's

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\* *Throckmorton v. Holt*, 180 U. S. 552, p. 565; *Int. Com. Commission v. Louisville & Nashville R. R. Co.*, 227 U. S. 88, p. 93, *supra*, holding that the right to offer evidence in “explanation” is a constitutional right.

does not constitute substantial evidence. The Commission made only the erroneous and wrongful finding applied to Petitioner's proof alone, i.e., that it is not "conclusive", by which (as Petitioner has demonstrated in its opening Brief, pp. 9, 40, 41, 114, 115, 116-121, and the Commission in its Brief makes no attempt to specifically deny) Petitioner was effectively deprived of its day in court and denied due process of law.

15. At pages 56-57 of its Brief the Commission resorts to a series of distortions of the whole purpose and intent of the testimony and experiments of the Petitioner's witness, Dr. Hazelton, which is proof positive of the Commission's bias and fixed closure of mind, culminating with the misleading statement (Commission's Brief, pp. 56-57) that "Since in his experiments Dr. Hazelton injected aloes and podophyllum *intravenously* into the dogs and in the experiments conducted by the Commission's witnesses these drugs were injected into the duodenum of the dogs, *the experiments are totally different*".

The misleading nature of this statement is demonstrated by (1) Ivy's statement in Commission's Ex. 98 (reproduced in full at p. 563, Vol. II, O. R., Ivy) being the Commission's witness, Ivy's, account of his own experiments, that "In this report we shall present the results obtained when the ingredients of Carter's Little Liver Pills were given *intravenously* or intraduodenally," (2) by the Commission's witness, Ivy's own testimony (Vol. IV, O. R., Ivy p. 630) that "we would inject a suitable solution of Carter's Little Liver Pills *intravenously* and then wait for another half hour or two hours", (3) by the statements with regard to Ivy's experiments in the Commission's Brief itself (p. 45) "six of petitioner's laxative pills were ground and dissolved in alcohol, diluted with water and injected *intravenously* twelve times in seven days" and again as to the experiments of its witness, Ivy, (Commission's Brief p. 46) "After one and one-half to two hours, 2 of petitioner's laxative pills were dissolved in a solution of alcohol and water and injected slowly *intravenously* into the dogs

and finally, of course, (4) by the fact that Dr. Hazelton's experiments involved also administration of aloes and podophyllum duodenally as did Ivy's (Examiner's Original Report, Vol. I, p. 225, and Hazelton N. R., Vol. II, pp. 73, 748, 749, Petitioner's Ex. 14).

Proof of the futility of the Commission's further denials (Commission's Brief pp. 56-58) of the materiality and relevance of Dr. Hazelton's experiments are, among other things, the strenuous efforts (Hazelton; N. R., Vol. II, 729, 741-746) which the Commission's Counsel made on the hearing to exclude the testimony of Dr. Hazelton explaining their effect and purpose, namely to prove the truth of the assertions made at pp. 34-39 of Petitioner's Opening Brief that Ivy's short term dog experiments (Commission's Ex. 98, O. R., Vol. I, p. 563) undertaken to show that Carter's Little Liver Pills do not increase the flow of bile were worthless because the tests were not prolonged for a sufficient period of time to allow the delayed action of the drugs, aloes and podophyllum, (8 to 12 hours as Ivy testified) to take effect.\*

That the Commission's Examiner well understood the relevance and materiality of Dr. Hazelton's assault, through his experiments and testimony, upon Ivy appears clearly (Hazelton, Vol. II, N. R., 728-729):

"Mr. Hanaway: \* \* \* I am going to argue later on in the case that this method in certain respects was identical with the method used by Dr. Ivy. I think I am entitled to ask this expert why it was that the results that he obtained on these six dogs were inconclusive. It goes directly to the issue in the case."

"Trial Examiner Purcell: Are you attempting to get your own witness to say that the experiments which he conducted, now introduced in evidence, are inconclusive?"

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\* See the uncontradicted testimony of Petitioner's witness, Dr. McGuigan, also ignored by the Commission (Vol. III, N. R., p. 896), confirming the length of time required for the action of these drugs, and the testimony of Dr. McGuigan, similarly ignored (Vol. II, N. R. 852 and Vol. II, O. R. 925-27), conclusively exposing the fallaciousness of Ivy's experiments.

"Mr. Hanaway: No. I am trying to establish that this method for determining bile flow is *not a sufficiently sensitive method.*"

Precisely, in other words, what the Commission, in its Brief, as shown above, has unwarrantably taken Petitioner to task for claiming to have demonstrated in its Opening Brief, namely *that the methods and liver function tests employed by the Commission's expert witnesses were not sufficiently refined for their purposes.*

Then, after objections by the Commission's Counsel, preliminarily sustained by its Examiner (*id.* 728, 729) and further objections from Commission's Counsel (*id.* 737, 738) again preliminarily sustained by its Examiner (*id.* 741-746), the Petitioner's witness, Dr. Hazelton, was finally permitted to answer (*id.* 746-747) that "following intravenous administration the total stimulant action of aloes is not complete within two hours", and after still further objections by the Commission's Counsel (*id.* 747) Dr. Hazelton was allowed to answer that (*id.* 748) "It is a fundamental pharmacological principle that the intravenous route of administration produces results more rapidly than the oral or the comparable duodenal administration, and since in our tube experiments, as has been brought out, we did not carry our period of observation beyond two hours, I feel that we could not have possibly made those tube experiments valid."

"Trial Examiner Purcell: I see.

"The Witness: Even after *intravenous* injection it takes two hours and that is as long as we ran those experiments" (*id.* 748).

Subsequently the Trial Examiner commented (*id.* 749-750):

"The witness now says that the allotted time is incomplete *both duodenally and intravenously*".

"Mr. Hanaway: He did not say that." \* \* \* He said that the period that he allotted for the collection of the bile in the tube, t-u-b-e dogs was not long enough, that two hours was not long enough to allow the full and complete action of these drugs."

"Trial Examiner Purcell: In other words, to form a full evaluation of the action of the drugs, is that right?"

"Mr. Hanaway: That is right, and if you will recall Dr. Ivy's experiments were on periods of time in one case in Exhibit 98 I think they were for as short as one hour. His periods of observation were as short as one hour." \* \* \*

"Confirming my remarks now to the tube dogs, all they show is that the two hour period was insufficient; so far as the intravenous dogs are concerned those experiments are complete." \* \* \* "It indicates that Dr. Ivy's work was incomplete, and that is what I am putting it in for." \* \* \* "not for the purpose to show that *this man's*\* work was incomplete but to demonstrate that *Dr. Ivy's work is incomplete*. I think I am allowed to do that." (*id.* 750).

The Commission through its Counsel then renewed its objections and also moved to strike Dr. Hazelton's answers but was overruled by the Examiner (*id.* 750-752) who, however, along with the Commission, gave neither effect nor proper consideration to their destructive impact and the destructive impact of Hazelton's experiments on the Commission's witness, Ivy's, experiments. The Commission's whole distorted treatment in its Brief, pp. 56-58 of Dr. Hazelton's experiments and evidence demonstrates that the Commission even now persists not only in ignoring but in positively distorting the purpose and effect of Dr. Hazelton's experiments and testimony — namely to demolish Ivy's. It is no wonder that the Commission also erroneously ignored the forceful testimony of Petitioner's witness, Dr. McGuigan, exposing the "absurdity" of Ivy's protocols (McGuigan, Vol. II, O. R. 924-927) ending with his denunciation of Ivy's Paper (Commission's Ex. 97). "Q. Is there anything else wrong? A. There is a whole lot in the thing. The paper is so full of errors in computation it is just the worst paper I have ever seen published, as far as errors go.

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\* i. e. Dr. Hazelton's.

There are more errors in that paper, I think, than any paper I have ever seen published. Lieutenant Annegers says those are typographical errors. They are not. They are changed figures. I recognized them."

16. Next (Commission's Brief p. 57), although it has been repeatedly pointed out to it by Petitioner's former Briefs that its own witnesses pursued the same practices,\* the Commission makes further demonstration of its persistent bias in its credibility evaluations of its own and the Petitioner's witnesses by again repeating its discrediting of Petitioner's witness, Dr. Morrison, because he did not tell his experimentees that they were receiving "administration of petitioner's laxative pills", etc., etc. Of course, characteristically the Commission took no note in its decision of the condemnation of Ivy's paper (Commission's Ex. 97) by the Petitioner's witness, Dr. McGuigan, (Vol. II, O. R. 924-927), "There are more errors in that paper, I think, than any paper I have ever seen published. Lieutenant Annegers says those are typographical errors. They are not. *They are changed figures. I recognized them.*" No further comment is necessary.

17. Finally the assertions by the Commission in its Brief (pp. 58-64) under the heading "Petitioner Was Not Denied A Fair and Impartial Hearing", and the Commission's insinuations that Petitioner should have moved before to disqualify the Examiner, amount to precisely nothing.

In view of the severe castigation by this Court in its prior opinion of the Commission's Examiner's tactics (which tactics the Commission had previously approved despite Petitioner's protests in its original Brief filed with the Commission at the close of the hearings and which tactics the Commission still approves) which were held by this Court to amount in effect to a complete

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\* See also Petitioner's Opening Brief p. 47 last paragraph and pp. 48-49 showing that Commission's witness, Dr. Case, pursued, without any criticism whatsoever on the Commission's part, similar practices.

denial to Petitioner of due process and “*to deprive petitioner of a fair hearing*”, it is obvious that, in fairness to the Commission, Petitioner was entitled to assume that both the Commission and its Examiner would heed this Court’s admonishments, amend their ways and dutifully proceed to correct the mispractices which this Court held to have deprived this Petitioner of its constitutional right to a fair hearing, and to refrain from a repetition of such practices. Petitioner was entitled also to persist in its belief (though it later proved to be a fond one) that the Commission’s Examiner would not again turn a deaf ear to the spirit and purpose of this Court’s opinion and mandate, and Petitioner was fully justified in so doing up to the very last when the Examiner’s pent up animus and bias finally burst into the clearest light of day\* in the extravagant and false series of charges of abuse of process by Petitioner and its Counsel and all of the Examiner’s other venomous insinuations and false innuendoes, including his belittling of the basis of Petitioner’s former highly necessary and justified appeal to this Court and of this Court’s holding sustaining that appeal, fully revealed for the first time in the Examiner’s Rulings and Supplementary Report (Petitioner’s Opening Brief, pp. 122-133).

Nowhere in the Commission’s Brief does it make either any attempt or demonstration—as of course it cannot—to overcome the overwhelming proof contained in this Reply Brief and in the Opening Brief of Petitioner, that its Examiner (and for that matter the Commission itself) was plainly and prejudicially biased.\*\* The Commission contents itself with the lame statement (Commission’s Brief p. 60) “that any bias and prejudice of the examiner

\* On the vitiating effects of bias first clearly appearing during trial, *Whitaker v. McLean*, 118 F. (2) 596; *Knapp v. Kinsey*, 232 F. (2) 458; *Knapp v. Kinsey*, 235 F. (2) 129 and cases cited in Petitioner’s Brief on its Motion to Disqualify the Examiner, dated April 25, 1955 at pps. 3-6, which is a part of the Record filed in this case.

\*\* And of the demonstration of the consequent futility of introduction in evidence by Petitioner before such an Examiner of the new Twiss experiments performed since the original hearings (Petitioner’s Opening Brief, pp. 134-145).

which may have existed cannot form a basis for a determination that petitioner was denied a fair and impartial trial unless the Examiner committed some *act* either in refusing to admit testimony, exhibits or in restricting the rights of petitioner in some manner resulting in prejudicial error". This statement complacently ignores, and fails to answer, the overwhelming proof of *just* such acts on the Examiner's and on the Commission's own part demonstrated from this very record, (including restrictions on the Petitioner's constitutional rights of cross examination and rebuttal) in Petitioner's Opening Brief and in this Reply Brief condemned as prejudicial error by the Supreme Court in *Alford v. U. S.*, 282 U. S. 687, pp. 291-2, and *Int. Com. Commission v. Louisville & Nashville R. R.*, 227 U. S. 88, p. 93.

18. Added to that detailed demonstration, is the following further proof that in adhering to its Examiner's Reports and Recommendations, the Commission was also further misled into making various Findings because of the Examiner's misstatements of the evidence contained in his Original Report.

In this Report the Examiner indulged in the misleading practice of creating the false impression in the Commission's mind that examination of Petitioner's own witnesses disclosed damaging admissions by them. As a typical instance (Vol. I, O. R., p. 215, Examiner's Original Report) in the Examiner's zeal to discredit Petitioner's witness Dr. Killian's experiments in a point vital to Petitioner's case (which in the Commission's eyes, at least, he appears to have succeeded in doing) the Examiner reports in criticism of Dr. Killian,

"373. *On further examination of the witness [i.e. Killian]* concerning the last hereinabove set forth conditions for increase of the bile flow, it developed:

"374. That the administration of the pills will not increase bile flow in the duodenum when given in adequate doses over a sufficient period of time to produce laxation as set forth in Condition 1 above, (Tr. 9591-92, 9525-26)".

These Transcript references, as the Court will see by examining the printed record where these references to the Transcript occur (O. R., Vol. IV, pp. 1553-4, *Ivy*, and O. R. id. 1533; N. R., Vol. VII *Ivy* pp. 2738-9) are *not* to the examination of Petitioner's witness, *Dr. Killian*, at all *but*, on the contrary, to the testimony and examination of the Commission's witness, *Dr. Ivy*. At other times, a variant of these misleading practices of the Commission's Examiner was to put the words of the Commission's witnesses into the mouths of witnesses for the Petitioner with the object again of creating the false impression in the Commission's mind that Petitioner's witnesses were themselves making damaging admissions. For example (Vol. I, O. R., Examiner's Original Report p. 205), and again as to Petitioner's witness, *Dr. Killian*, the Examiner reports, "Witness (i. e. *Killian*) testified that even had the administration of Carter's Little Liver Pills under the conditions of his experiments produced an increase in the flow of bile, such increase would serve no utilitarian purpose (Tr. 7828, 9097, 9602-9603)". Again, as this Court may see from examining (N. R., Vol. V, p. 2224 and N. R., Vol. VI, p. 2225) where the first of these references to the Transcript occur, there is no such statement by Dr. Killian; and if the Court examines O. R., Vol. IV, p. 1432, *Bollman*, and N. R., Vol. VII, pp. 2768-9, *Ivy*, where the next two references to the Transcript occur, the Court will see that the *one* is to testimony of Commission's witness *Dr. Bollman* (and *not* to Killian) having nothing to do with the subject, and that the other is to the Commission's witness *Ivy's* testimony (and *not* Killian's testimony) agreeing in part and disagreeing in part with Dr. Killian's testimony.

Still more prejudicial to Petitioner is this further variant of the Examiner's misleading practices in his Report—prejudicial because it was intended to, and doubtless did accomplish the result of misleading the Commission into a distrust of the thoroughness and adequacy of the experimental protocols of Dr. Morrison. The Examiner (O. R., Vol. I, Examiner's Report pp. 147-8), under the heading "Cross examination of Dr. Morrison developed the fol-

lowing testimony", finds in effect that the cross examination of Dr. Morrison revealed defects in his protocol because of the administration *concomitantly* with aloes and podophyllum of another biliary stimulant, magnesium sulphate, so that, as the Examiner there concludes (*id.* pp. 147-148):

"\* \* \* Morrison made no attempt to determine, when the drainage was collected following the administration of magnesium sulphate, whether or not that drainage was affected by the aloes and podophyllum, and vice-versa, where the aloes and podophyllum were first administered followed by magnesium sulphate, no attempt was made to determine whether or not any effect remained from the previous injection."

In other words the Examiner reports in Morrison's case *only* as *fatal* to Morrison's protocol *alone*\* precisely the same type of fatal objection to Ivy's and Case's protocols which Petitioner makes in its Opening Brief—namely, the very same type of use by these witnesses for the Commission of bile salts, cholecystokinin and the fatty meal and all the other cumulative stimulants and upsetting variables from whose concomitant and combined use it was impossible to tell what effects were due to the aloes and podophyllum or to these other stimulants or to both.

19. The misleading statements in the Commission's Brief (pp. 61-2) which seek to make it appear to this Court that because Petitioner was permitted to cross examine Commission's witness, Bollman, as to *certain* contradictory textual authorities (though both the Commission and the Examiner ignored completely all effects of such cross examination and of such contradictory authorities)—no prejudicial harm was done, *omit* all reference to the all essential and important circumstance of the complete rejection and disregard by both Examiner and the Commission, which sustained that rejection, *of all the many other additional*

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\* No mention of these same objections is made by the Examiner in his Report concerning Ivy's and Case's experiments (*id.* 93-117).

scientific texts and authorities also flatly contradicting the testimony of the Commission's witnesses on vital areas of Petitioner's case. Some of these are discussed above in Reply Brief. All of them and the detailed legal reasons authorities for their admission and consideration by the Commission were urged upon the Commission in Petitioner's Appeal Brief dated November 29, 1955 (copies which have been supplied to the Court) at pp. 16-19; 26; 32-34 and at pp. 7-8 of Petitioner's Supplemental Brief on Appeal to the Commission, dated May 11, 1956, which is likewise a part of the record filed with this Court.\* With respect to *these other* rejected and important Exhibits whose existence was first discovered, and which were offered, while the proceedings were still pending—Bollman was not cross-examined. Because of the importance of these issues (and Petitioner's inability for space considerations to treat them adequately here) the Court is respectfully urged to read the full statements (above referred to) Petitioner's Brief and Supplemental Brief on Appeal to the Commission. These rejected offers of proof emanating from eminent medical authorities, most of whom were never recognized as authoritative by the Commission's witness, Bollman or otherwise properly established as authoritative, related (among other basic issues), to the important issue in this case of the validity of Petitioner's witnesses' use of the duodenal drainage method, and the admission and consideration of these authorities were subsequently essential to Petitioner's basic rights.

To these legal authorities demonstrating the Commission's error in failing to receive in evidence or take official notice of these medical texts offered by Petitioner and rejected by the Commission, should be added the following authorities demonstrating that without further proof or other authentication the Commission *should* have received

\* See also Petitioner's Opening Brief, p. 30, and Federal Administrative Procedure Act (5 U. S. C. 1006(d)). Commission's Counsel made no request to disprove these matters of which the Commission and the Examiner were requested to take notice.

and considered them and that this Court *can*, itself, consider them on the present appeal:

On this very issue of "consensus of medical opinion", the Court in *Kelly v. Maryland Casualty Co.*, 45 F. (2) 782, pp. 784-5, on its own initiative consulted dozens of medical textbooks which had neither been authenticated, offered nor introduced in evidence, in order to determine this same issue. In fact the Court held p. 784 "*It is the duty of a judge in my situation to inform himself as well as he reasonably may concerning the reasons for differing medical opinions before he undertakes to make choice between them.*" Here the Commission deliberately made arbitrary choice between two differing sets of general medical opinion on the two key issues of this case, i.e., the reliability of duodenal drainages and the relationship between bile flow and constipation, without even considering the differing opinions contained either in the contradictory medical texts with respect to which Bollman was actually re-cross-examined or in those which were included in Petitioner's Offers of Proof and rejected by the Commission. On the other hand Judge Clark in *Belmont Laboratories v. Federal Trade Commission*, 103 F. (2) 538 p. 539 himself consulted innumerable such texts not authenticated and not offered in evidence and based his decision thereon in a similar proceeding. So did the Supreme Court in *Jacobson v. Massachusetts*, 197 U. S. 11 and *Brown v. Board of Education*, 347 U. S. 483. In *Application of Norris*, 179 F. (2) 970, the Court acceded to a request in counsel's brief to take judicial notice of two text books on organic chemistry—an inductive science—and quoted extensively from these texts in support of its opinion. See also to the same general effect *Washington State Apple Advertising Commission v. Federal Security Administrator*, 156 F. (2) 589 (9th Cir.) *Beach v. Beach*, 114 F. (2) 479; *Canadian-American Pharmaceutical Co. v. Coe*, 126 F. (2) 847, and *Durham v. U. S.*, 214 F. (2) 862, in which the Courts themselves cited, used and took note of plaintiff's texts not introduced in evidence, and this Court's opinion in *Willapoint Oysters v. Ewing*, 174 F. (2) 676, p. 689, in which in a footnote this Court cited

textbook to show that the government's organoleptic examinations were "less efficiently conducted and with less populous regard to scientific media."

It is elementary that "The Court may inform itself in books of authority, though not introduced in evidence, may admit such works to aid it in the exercise of its judicial function"; *In re Siemen's Estate* (Sup. Ct., Pa.), 18 A. (2) 280, p. 282, cert. den. 320 U. S. 758. *A fortiori* this true of administrative agencies which are not bound by technical rules of evidence. In *Nicotra v. Bigelow Sanitary Carpet Co.* (Sup. Ct. of Errors of Conn.), 189 A. 603, Court said p. 606 "respondent claims that it was error for the Commissioner to receive the statement from a medical authority (i.e., Encyclopedia of Ophthalmology) under the claim that such statements are inadmissible. This claim overlooks the nature of the hearing before the Commissioner. On such a hearing, great latitude is committed to the Commissioner in the admission of evidence";\* compare Professor Kenneth Culp Davis "Evidence in the Administrative Process", 55 H. L. R. p. 419, State Court decisions from some eighteen jurisdictions collected in *Wigmore on Evidence*, 3rd Ed., Vol. 6, Section 10, p. 21, in which courts themselves uniformly take judicial notice of scientific matters and cite and consult textbooks (not introduced in evidence) as bases for their decisions. See *Chiulla DeLuca v. Board of Park Comm'r's* (Sup. Ct. of Errors, Conn.), 107 A. 611; *State Board of Medical Examiners v. Plager* (Sup. Ct. N. J.), 193 A. 698; *People v. Jennings* (Sup. Ct. Ill.), 96 N. E. 1077, p. 1081. Further recent decisions are *McKay v. State* (Texas), 235 S. W. (2) 173; *People v. Bobczyk* (Ill.), 99 N. E. (2) 107; *State v. D'Antonio* (Sup. Ct. N. J.), 115 A. (2) 371; *In re Mundy* (Sup. Ct. N. H.), 85 A. (2) 371; *Bailey American General Insurance Co.* (Sup. Ct. Tex.), 13 S. W. (2) 315, p. 321; *Loftin v. Yancey* (Sup. Ct. Okla.), 2 P. (2) 107; *Boschers v. Payne* (Sup. Ct., Idaho), 70 P. (2)

\* Authorities cited pps. 17-19 Petitioner's Brief in Appeal to Commission.

391, p. 395; *Guarantee Ins. Co. v. Industrial Acc. Commission* (Col. Dist. Ct. Appeal), 199 P. (2) 12; *Frank v. Atlanta Life Ins. Co.* (St. Louis Court of Appeals, Mo.), 211 S. W. (2) 940; *State v. Goettina*, 158 P. (2) 865, p. 877 (Sup. Ct. Wyoming); *Kennedy v. Parrott* (Sup. Ct., North Carolina), 90 S. E. (2) 754, p. 756. "It would make for greater expedition and for fuller utilization of administrative skills and knowledge if there were more liberality in respect of official notice", Final Report of Attorney General's Committee on Administrative Procedure, quoted with approval in *Pierce Auto Freight Lines v. Flagg*, 159 P. (2) 162, p. 177 (Sup. Ct. Oregon). It was clear reversible error for the Commission to receive hearsay evidence in support of its witness Dr. Case (Opinion Vol. I, N. R. 321) and yet to arbitrarily refuse to consider all these authoritative textual authorities particularly here where Petitioner's immediately valuable property rights in the trade name and good will of its product and the public's interest in the full benefit of an attested therapeutic product were both at stake and where "Due process requires an evaluation based on a disinterested inquiry pursued in the spirit of science"; *Rochin v. California*, 342 U. S. 165, p. 172.

Finally, the complete answer to the Commission's assertions (its Brief, pp. 62-63) concerning Petitioner's alleged failure to make "proper" application to introduce the new Twiss experiments is set out at page 2 of this Reply Brief.

No. 16573

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In the United States Court of Appeals  
for the Ninth Circuit

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Carter Products, Inc., petitioner

v.

Federal Trade Commission respondent

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PETITION FOR THE REVIEW OF AN ORDER TO CEASE AND  
DESIST

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RESPONDENT'S REPLY BRIEF

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EARL W. KINTNER,  
*General Counsel*

JAMES E. COONEY,  
*Associate General Counsel*,

JOHN W. CARTER, JR.,

FLETCHER G. COOK,

*Attorneys*,

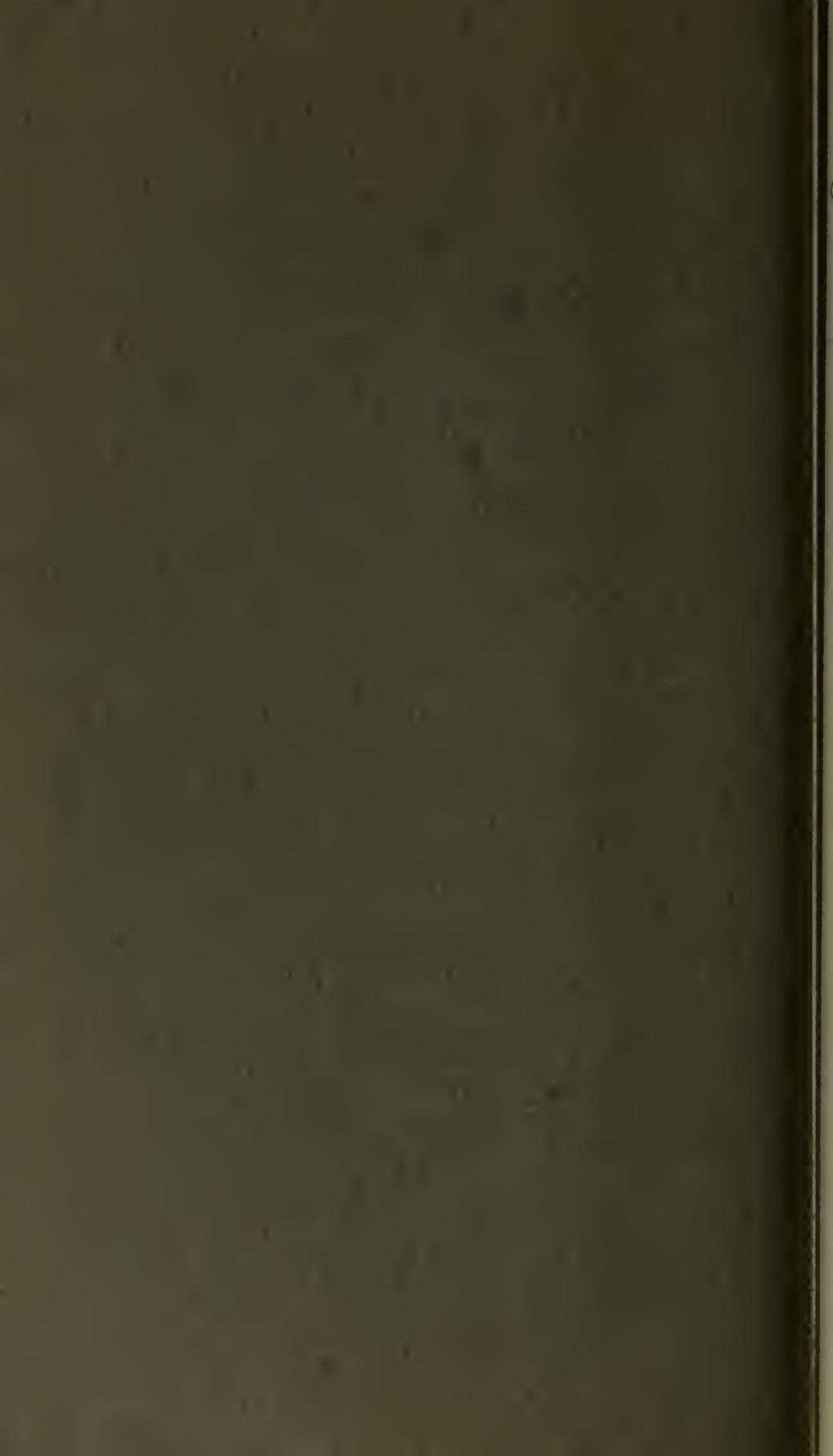
Attorneys for Federal Trade Commission

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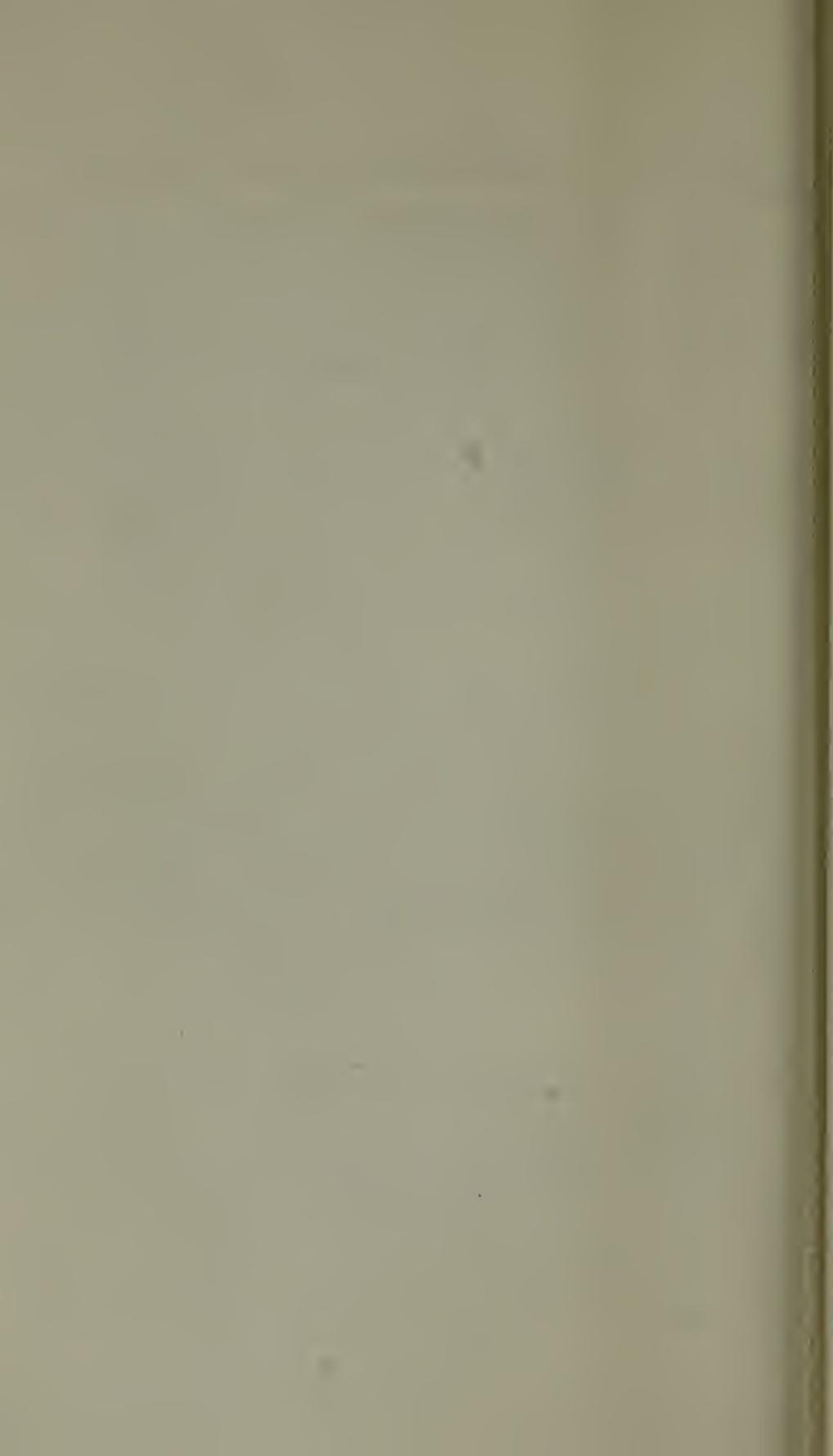
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# In the United States Court of Appeals for the Ninth Circuit

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No. 15373

CARTER PRODUCTS, INC., PETITIONER

v.

FEDERAL TRADE COMMISSION, RESPONDENT

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*ON PETITION FOR THE REVIEW OF AN ORDER TO CEASE AND  
DESIST*

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## RESPONDENT'S REPLY BRIEF

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Respondent objected to the filing of petitioner's reply brief on the ground that it exceeded the permissible length for such a brief. The objection was overruled, though respondent was granted permission to file a brief in reply.

Normally any answer to contentions raised in a reply brief would be made in oral argument and it is not our purpose to burden the Court with a further lengthy presentation of our views. But in view of the numerous contentions made by petitioner and the express permission granted, we are constrained to set forth as concisely as possible our position with respect to the major arguments advanced in petitioner's reply brief, reserving our further answer for oral argument.

The following points we believe to be particularly deserving of answer at this time: (1) that petitioner was justified in refusing to offer in evidence the experiments conducted by Dr. Twiss (Pet. Rep. Br. 2-3); (2) that differences in general medical opinion "deprives the Commission of any power at all to issue a cease and desist order" (Pet. Rep. Br. 3); (3) that the contention of the Commission: that the only issue properly

before this Court is whether the findings that petitioner's laxative pill will have no effect on the formation or flow of bile is supported by the greater weight of the evidence, is without substance or support (Pet. Rep. Br. 6-11); (4) that the Commission flouted the "spirit and purpose" of this Court's remand (Pet. Rep. Br. 11); and (5) that there was "material misstatements, omissions and distortions contained in the Commission's brief" (Pet. Rep. Br. 1a-34a).

1. In its reply brief (p. 2) petitioner characterizes the so-called Twiss experiments as "exhaustive scientific tests carefully conducted in accordance with proper and up-to-date scientific procedures" and as "new and unanswerable body of evidence" and states in a footnote that "Because of the importance in this case of Petitioner's Motions and Offers of Proof, the Court is respectfully urged to examine them in full"; and yet, when this matter was heard on its merits by the Commission and one of the Commissioners invited petitioner to seek the introduction of this evidence by a proper motion, petitioner refused to do so (R. 15373, Vol. VIII, 3496-3497).

Petitioner says (Rep. Br. 3) that the basis for its refusal was the bias and prejudice of the examiner and that to introduce this evidence before the examiner "would constitute the merest empty gesture neither affording the Petitioner due process nor any real or adequate remedy whatsoever." That constitutes neither a valid nor a legal basis justifying petitioner's refusal to introduce into the record the experiments conducted by Dr. Twiss.

At the close of taking testimony on remand, petitioner filed a motion before the Commission seeking to void the entire proceedings on the ground that the examiner was biased and prejudiced (R. 15373, Vol. I, 146-201). Prior to the argument of this case on the merits, the Commission denied that motion and determined that the examiner was not biased and prejudiced (*id.* at 245-257). The Commissioners offered petitioner an opportunity to introduce the experiments of Dr. Twiss and evidence relating thereto. Petitioner refused to do so on the ground that the examiner was biased and prejudiced. When petitioner takes upon itself the responsibility of refusing to introduce into the record evidence which it claims to be ma-

terial and essential to a proper determination of the issues in this case, it does so at its own peril, particularly when the reason upon which the refusal is based already has been determined by the tribunal to whom such evidence is to be presented for consideration and final evaluation.

Also, as we stated in our main brief (59), the procedure under which this case was heard limited the authority of the examiner to filing with the Commission a report and recommendation—the final determination of the issues was made by the Commission. Even if the examiner was prejudiced and biased as petitioner claimed, such bias and prejudice would not and did not justify petitioner's refusal to present his case to the Commission. Having been offered an opportunity to properly place this evidence in the record and not having taken advantage of this opportunity, petitioner should not now be heard to complain.

2. Petitioner's statement (Rep. Br. 3) that differences in general medical opinion “\* \* \* deprives the Commission of any power at all to issue a cease and desist order \* \* \*” is utterly ridiculous. Petitioner says in effect that a conflict in the testimony of expert witnesses, automatically revokes the authority granted the Commission by Congress, to order the discontinuance of unfair methods of competition or unfair or deceptive acts or practices. But the only requirement of the Act as to the findings made by the Commission is that they must be supported by substantial evidence. The legislative history discussed by petitioner is neither relevant to, nor does it have any bearing upon, the plain language of the statute as finally enacted.

On the basis of competent, credible, expert testimony and upon the results of scientific experiment and tests properly conducted by qualified experts, the Commission found that petitioner's laxative pill will have no effect on the formation or flow of bile. The courts, including this Court, have repeatedly held that findings so supported are conclusive and will support an order to cease and desist notwithstanding the fact that they relate to matters upon which there is a conflict of expert medical opinion. In *Irwin v. Federal Trade Commission*, 143 F. 2d 316, 323 (C. A. 8, 1944), rehearing denied

July 17, 1955, the court said: “\* \* \* But the evidence as a whole presented for determination of the issue of fact whether the representations were false, misleading or deceptive as charged. Such determination requires consideration of the testimony of the experts and decision upon conflicts between them in a field where there are few absolutes readily demonstrable. But such difficulties suggest no reason to deny the Commission's power to resolve the fact issue.”

In *Alberty v. Federal Trade Commission*, 118 F. 2d 669 (C. A. 9, 1941), rehearing denied April 21, 1941, cert. denied 314 U. S. 630, this Court said at page 670: “The Commission's findings are supported in part by the testimony of experts adhering to the homeopathic school, in part by the testimony of other experts. Conflicts in the testimony were for the Commission, not this court, to resolve. (Cases cited.) We cannot say that, in resolving such conflicts, the Commission acted arbitrarily.”

In *J. E. Todd, Inc. v. Federal Trade Commission*, 145 F. 2d 858 (C. A. D. C. 1944), the Court said: “The supporting evidence is substantial though the experts who gave it had no clinical experience with the product and the opposing experts had such experience.”

That the Commission has the authority to resolve conflicts in expert medical testimony has been determined in numerous cases.<sup>1</sup>

3. In its petition for review and in its statement of points relied upon, petitioner challenges generally the findings made by the Commission. It was, and still is, the position of the

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<sup>1</sup> See *John J. Fulton Co. v. Federal Trade Commission*, 130 F. 2d 85, 86 (C. A. 9, 1942), cert. denied November 9, 1942; *Aronberg v. Federal Trade Commission*, 132 F. 2d 165, 170 (C. A. 7, 1942); *D. D. D. Corporation v. Federal Trade Commission*, 125 F. 2d 679, 680-682 (C. A. 7, 1942); *Dr. W. B. Caldwell, Inc. v. Federal Trade Commission*, 111 F. 2d 889, 891 (C. A. 7, 1940); *Neff v. Federal Trade Commission*, 117 F. 2d 495, 497 (C. A. 4, 1941); *Justin Haynes & Co. v. Federal Trade Commission*, 105 F. 2d 988-989 (C. A. 2, 1939), cert. denied 308 U. S. 616 (1939). See also *Federal Trade Commission v. Raladam Company*, 283 U. S. 643, 646 (1931), in which, as appears from the decision below, *Raladam Company v. Federal Trade Commission*, 42 F. 2d 430, 433-435 (C. A. 6, 1930), there was substantial conflict in the evidence of medical experts. This was also true in *Federal Trade Commission v. Raladam Company*, 316 U. S. 149 (1942), although not apparent from the report of the case in the Supreme Court or the court below.

Commission that such challenge was so general in its nature and the errors claimed so vague and indefinite that the Commission could not be expected to set up straw men just to knock them down. This Court said in *North Whittier Heights Citrus Assn. v. National Labor Relations Board*, 108 F. 2d 76 (C. A. 9, 1940), cert. denied 310 U. S. 632 (1940), at page 83: "We need not consider this point for the reason that petitioner does not point to any single instance in the record supporting the assertion. We are not compelled to search the record for un-designated error claimed upon an omnibus assertion." In the absence of such designation, the Commission's findings are presumed to be "supported by substantial evidence," *Federal Trade Commission v. A. McLean & Son*, 84 F. 2d 910, 911 (C. A. 7, 1936), cert. denied 299 U. S. 590 (1936).

Furthermore, rule 18 (2) (d) of the Rules of this Court provide, *inter alia*, that petitioner's brief shall contain ". . . a specification of errors which shall be numbered"; that ". . . when findings are specified as error, the specification shall state as particular as may be wherein the findings of fact and conclusions of law are alleged to be erroneous . . ." In its main brief (pp. 6-10), petitioner set forth 12 numbered paragraphs under the heading "Specification of Errors and Summary of Argument." Specifications numbered 1 through 9 begin with the phrase "The Commission's findings." This phrase standing alone includes all findings of fact made by the Commission. However, when read in connection with the summary under each specification, it is plainly apparent, as the Commission pointed out in its main brief at page 12, that in specifications 1 through 8<sup>2</sup> petitioner contended that the findings are erroneous because of the alleged method and manner in which the Commission considered or failed to consider the testimony and other evidence relating to experiments and tests conducted by experts for the Commission and for petitioner. All of this evidence relates specifically to and was admitted in the record as responsive to the issue raised by the pleading as to the effect of petitioner's laxative pill upon bile production and flow.

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<sup>2</sup> Specification 9 has to do with the issue of a fair and impartial hearing.

In its opening brief (10-168), petitioner developed its argument under three points. Its entire argument, except that portion devoted to the issue of a fair hearing, was directed only to the findings made by the Commission in reference to the effect of petitioner's laxative pill upon the production and flow of bile. There is not a single statement in its entire argument that refers to the numerous other findings made by the Commission. Petitioner contended that the findings in reference to the effect of its laxative pill upon the flow of bile were erroneous because of the method and manner in which the Commission considered or did not consider the evidence and testimony in reference thereto. Faced with a lengthy brief containing argument relating solely to certain specific and designated findings, the Commission could not reasonably be expected to do more than answer that argument and certainly could infer that petitioner had abandoned any claim of error with respect to the numerous other findings. The Commission, therefore, limited its argument to the sole issue raised and argued by petitioner.

In *Moore v. Tremelling*, 100 F. 2d 39, 43 (C. A. 9, 1938), the Court said: "Appellants' assignment of error . . . relating to the correctness of the Court's instruction on the statute of limitations not being argued or discussed in the brief is abandoned." And in *Radius v. Travelers Insurance Co.*, 87 F. 2d 412, 413 (C. A. 9, 1937), this Court said: "The appellant's assignment of error contains eight assignments, of which four are set out in appellant's brief. The four not pressed in the brief are deemed abandoned and will not be considered"; also, see *Donnelly v. United States*, 376 U. S. 505, 511 (1928); *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U. S. 359, 369 (1927).

In *Peck v. Shell Oil Co.*, 142 F. 2d 141 (C. A. 9, 1944), this Court said at page 143: "With respect to many of the 'points' stated by appellants no argument or discussion is presented in their opening brief. Therefore, those 'points' are deemed abandoned and need not be considered herein" and cases cited therein.

In *Stetson v. United States, et al.*, 155 F. 2d 359, 360 (C. A. 9, 1946), this Court said: "Errors assigned but not argued are deemed waived," citing cases in footnote 5. Also see *Western*

*Nat. Ins. Co. v. Le Clare*, 163 F. 2d 337, 340 (C. A. 9, 1947), rehearing denied October 24, 1947. In 5 Federal Digest, pages 218-229, numerous cases are cited in support of this proposition.

We do not contend, of course, that this Court does not have the authority and power *sua sponte* to consider and determine every issue raised below by the pleadings, whether such issues are argued by petitioner or not but we do point out that in the absence of good and compelling reasons to the contrary (none of which exist here), not only has this Court but all other Courts of Appeals and the Supreme Court of the United States, limited consideration to the issues actually briefed and argued by a petitioner.

While we are confident that the only issue properly before the Court is that which relates specifically to the effect of petitioner's laxative pill upon the production or flow of bile, we are equally confident that the Commission's findings as to the other false and misleading representations made by petitioner are supported by substantial evidence. (See *infra*. 16-17.) During the examination of medical experts placed on the stand by counsel in support of the complaint, and in some instances by petitioner's counsel, counsel supporting the complaint examined the witnesses as to the various exhibits containing the representations as to the therapeutic value of its laxative pills, which were admittedly disseminated by petitioner, and asked them whether such representations were true or false.<sup>3</sup> In each instance, the witness replied that they were false. Except as to the representation that petitioner's laxative will affect the production or flow of bile, petitioner's counsel made no effort whatever to establish the truth of the other representations made in petitioner's advertisements as to the therapeutic value of its laxative pill.

4. Petitioner's contention that the Commission flouted the spirit and purpose of this Court's remand is wholly without foundation. The Commission speaking through Commissioner

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<sup>3</sup> For example, see R. 12940, Vol. III, 934 in which petitioner's witness, Dr. Sanford, testified that he thought the representation contained in petitioner's advertisement (CX 1-13) "is all hooey"; see also R. 12940, Vol. I, 386-391.

Kern, stated its position as to the requirement placed upon the Commission by this remand. Commissioner Kern said (R. 15373, Vol. I, 324):

It seems obvious to us, therefore, that the reason for the Court's action setting aside the Commission's order to cease and desist was that the respondent had been denied a fair hearing before the Commission in that the hearing examiner unduly and prejudicially restricted the respondent's [petitioner's] right to cross-examine Doctors Bollman, Lockwood and Case. It seems equally obvious that the purpose and effect of the remand was to enable the Commission to correct the errors in this respect by recalling these witnesses for full cross-examination. This the Commission has undertaken in good faith to do. At a hearing held in Santa Barbara, California, Doctor Case had been recalled to the stand and tendered to the respondent for further cross-examination. After 130 pages of testimony had been received, the respondent's [petitioner's] counsel had announced "I have asked all the questions I want to ask" (R. 10838). At a subsequent hearing held in Washington, D. C., Doctor Bollman had been recalled to the stand and thereafter further cross-examined. After 268 pages of testimony had been received, the respondent's [petitioner's] counsel had again announced "I have no [further] questions" (R. 11193). Doctor Lockwood, the third witness the Court held had been improperly curtailed, had, in the meantime, died. In view of his unavailability for further cross-examination all of his testimony and all exhibits theretofore offered in support thereof had been, on the respondent's [petitioner's] motion, stricken from the record. Thus the purpose and intent of the remand had been fully served. The additional matters proffered by the respondent [petitioner] essentially constituted cumulative evidence similar in vein to that introduced by the respondent [petitioner] at the original hearings. They were in no sense within the purview of the Court's remand to the Commission or the Commission's remand to the hearing examiner, neither of which con-

templated use of the supplemental hearings for retrial of the issues and matters as to which full hearing or opportunity therefor had been afforded in the original hearings, and the hearing examiner's action in rejecting this additional evidence is not regarded as erroneous.

In *Labor Board v. Donnelly Garment Co.*, 330 U. S. 219 (1947) (one of the cases cited by the Supreme Court in its order granting certiorari), the Court said at pages 225-226: "This second hearing was not a new proceeding . . . The Board [National Labor Relations Board] was justified in not deeming itself under duty to grant a 'new trial' . . ."; and at page 228 said: "Due process does not afford a party the right to treat as a rehearing a hearing on the issues for which the hearing was adequate . . . Since in our view the remand did not call for a proceeding *de novo*, the Board was not required to reopen any issue as to which its ruling was left unassailed by the Circuit Court of Appeals in its first decision . . ."

It was upon the basis of the decision of the Supreme Court in the Donnelly case that the Commission expressed its opinion as hereinabove set forth that the remand did not contemplate the retrial of issues and matters left unassailed by the decision of this Court setting aside the Commission's order to cease and desist. We submit that it cannot reasonably be said, as petitioner does, that the Commission has flouted the spirit and purpose of the order of this Court remanding this case to the Commission.

5. We shall take up, *seriatim*, the points set forth in that portion of petitioner's reply brief designated Appendix A. In order to avoid repetition in making such comment we point out to the Court that petitioner in its Appendix (4a, 6a, 8a, 11a, 12a, 13a, 14a, 17a, 19a, 20a and 31a) constantly cites excerpts from "Textual Authorities" as if such authorities had been admitted into evidence and relies upon them to sustain its contention that the Commission has omitted in its main brief evidence establishing certain facts. These "textual authorities" are not in evidence. Some were marked for identification and some are part of petitioner's offers of proof.

1. No comment.

2. Petitioner quotes the testimony of Dr. Bollman (Rep. Br. 1a) in referring to the statement made by the Commission in its main brief (Res. Br. 16) that if there is an impairment of the liver which cuts the production of bile 80%, there still would remain sufficient bile for the proper digestion of fat food. Actually the testimony of Dr. Bollman quoted by petitioner establishes the truth of the statement. It is uncontradicted in the record that a liver so damaged or impaired is capable of producing sufficient bile to carry on the digestion of fat foods (R. 12940, Vol. IV, 1417, 1478, 1556-1557).

Whether Dr. Morrison knew or did not know of any ambulatory cases of individuals whose livers were 80% deficient is wholly immaterial.

3. Petitioner states (Rep. Br. 4a-5a) that when the Commission told the Court (Res. Br. 16) "an individual does not require the production of 2 pints of bile daily to prevent digestive disturbances," the Commission failed to also tell the Court that Dr. Palmer testified that one of the functions of the liver is to excrete 2 pints of bile into the bowels each day. But this testimony of Dr. Palmer does not affect the statement made. The amount of bile that the liver normally excretes and the amount of bile that is essential to digest fat foods are entirely different. It is uncontradicted in the record that 2 pints of bile daily are not necessary to the digestion of fat foods (R. 12940, Vol. II, 673-674).

Furthermore Dr. Palmer himself testified that the statement appearing in one of petitioner's advertisements, "It takes those good old Carter's Little Liver Pills to get those 2 pints flowing freely," was false and just propaganda (R. 15373, Vol. II, 648).

4. Petitioner using the testimony of Dr. Morrison also attacks (Rep. Br. 5a-6a) the statement made by the Commission (Res. Br. 16) to the effect that there is no evidence that any doctor ever prescribed petitioner's laxative pills for any purpose other than to produce an evacuation of the bowels.

An analysis of Morrison's testimony, however, establishes that insofar as petitioner's laxative pill is concerned, he used them only when biliary dyskinesia "was associated with chronic

constipation." And, it is obvious, therefore, that when he did use the pills, it was for the purpose of producing an evacuation of the bowels.

5. No written comment deemed necessary. Comment, if required, will be made during oral argument.

6. No written comment deemed necessary. Comment, if required, will be made during oral argument.

7. No written comment deemed necessary. Comment, if required, will be made during oral argument.

8. In its reply brief (13a-14a) petitioner refers to the testimony of Dr. Ivy in an effort to convince this Court that because Dr. Ivy testified that duodenal drainages are reliable for testing a "potent stimulant", that this testimony in some manner established the fact that aloes and podophyllum, the ingredient of petitioner's laxative pill, are potent stimulants. Nothing could be further from the truth. Dr. Ivy testified as follows:

Q. Doctor, what do you mean by the expression "potent substance"?

A. An active substance.

Q. Do you consider Carter's Little Liver Pills or aloes or podophyllum as such?

A. Not for promoting the flow of bile into the duodenum. They are potent as far as laxation is concerned (R. 12940, Vol. IV, 1537).

9. No written comment deemed necessary. Comment, if required, will be made during oral argument.

10. No written comment deemed necessary. Comment, if required, will be made during oral argument.

11. Petitioner (Rep. Br. 16a-17a) once more seeks to have this Court weigh the evidence in the case. We have hereinbefore pointed out this function belongs to the Commission and not the Court.

Petitioner states (Rep. Br. 16a-17a) that it was foreclosed from the proper cross-examination of Commission's witness Ivy which, according to petitioner, would have demonstrated that Dr. Ivy virtually admitted that the test animals had "reached the peak of their ability to put out any further bile in response to the administration, on top of these bile salts,

of doses of petitioner's product." A short reply to this is that the matter found on pages 18 and 19 of petitioner's opening brief, cited by petitioner in support of its contention here, has nothing whatever to do with the administration of bile salts to the test animals. Not knowing exactly to what petitioner refers, we are unable to reply. However, Dr. Ivy testified that dogs of the weights used by him in his experiments normally would excrete from 8 to 10 grams of bile salts daily. He further testified that this ability to excrete this amount of bile salts a day was far in excess of the 2 grams of bile salts which he administered to these dogs each day (R. 12940, Vol. IV, 1562-1563).

It is true that the particular experiments of Dr. Ivy, to which petitioner refers (Rep. Br. 17a), were concerned only with the determination of the possible effect of petitioner's laxative pill on the formation of bile by the liver (choleretic effect). However, other experiments performed by Dr. Ivy, as well as those performed by other scientists, and the opinion testimony of experts, all of which we discussed in our brief (Res. Br. 42-51), demonstrate that the pills also had no effect on increasing the flow of bile "by facilitating gall bladder evacuation" (chologogic effect). Furthermore, other evidence in the record which we discussed (Res. Br. 51-54) uncontradictedly prove that the pills had no effect on promoting the flow of bile by any other means. Thus, the overwhelming weight of the evidence in the record—for the most part uncontradicted—is that petitioner's laxative pill has no effect on either the formation or flow of bile.

12. Petitioner tells the Court (Rep. Br. 17a) that the Commission in its main brief (33) quoted Dr. Crandall as testifying "that he did not think constipation under any circumstances decreased the flow of bile to such an extent as to affect the digestive process." Petitioner is in error when it claims that the Commission quoted the testimony of Dr. Crandall. Actually the Commission gave what it thought to be a fair summary of the following testimony of Dr. Crandall appearing in Record 12940, Volume IV, page 1672:

Q. Doctor, do you think that constipation under any circumstances decreases the flow of bile to such an ex-

tent that there is not sufficient bile in the duodenum to carry on the function of bile in the human digestive process?

A. No.

Q. Would you say that it [constipation] would decrease either [sic] the secretion of bile to such an extent that there would not be sufficient bile in the system to carry on the function of the bile?

A. I know of no evidence to indicate that.

In the testimony of Dr. Crandall quoted by petitioner in its reply brief (17a), Dr. Crandall merely stated that he thought constipation *might* decrease the flow of bile. This testimony in no way contradicts his former testimony that even if such decrease appeared, there would still be sufficient bile to carry on its function in the digestive process.

13. Petitioner states (Rep. Br. 19a) that the Commission gave no record references to support the statement that Dr. Ivy conducted a second series of experiments "after the effect of the above experiments on the dogs had worn off." But on page 46 of the Commission's main brief, the record is referred to as follows: "R. 12940, Vol. II, 641-643." In addition to the above, petitioner complains that the animals were under the effect of anesthesia during these experiments. Due to the type of experiments, there is nothing remarkable about this. In the experiments conducted by Dr. Hazelton, petitioner's own witness, the dogs were anesthetized (R. 15373, Vol. II, 726).

14. Petitioner told the Court (Op. Br. 107) that the conditions which Dr. Killian testified to "were the very conditions in which petitioner's product was intended, designed and claimed to be of benefit." It is interesting to note that in its reply brief (21a) petitioner now tells the Court that the conditions under which its laxative pill will increase bile flow are not confined to the conditions of Dr. Killian's experiments. Obviously, petitioner is blowing hot and cold.

Petitioner complains that when Dr. Killian was endeavoring to explain that the effect of petitioner's laxative pill on bile was "not confined to the four conditions of his experiments," he was prevented from doing so by the examiner and that this

was a flat denial of petitioner's constitutional due process. It is true that at one point during the cross-examination of Dr. Killian he attempted to express an opinion when counsel supporting the complaint had not asked him for one (R. 12940, Vol. III, 1282-1285). But on redirect examination, Dr. Killian was given the opportunity to express the opinion which he had attempted to give voluntarily on cross-examination (id., 1310-1315), so there can hardly be any claim of prejudicial error.

15. Petitioner's argument (Rep. B. 22a-26a) is merely a continuation of its attack upon the experiments conducted by Dr. Ivy and goes to the credibility of Dr. Ivy's testimony and the weight to be accorded thereto. We notice, however, that the attack is similar to that petitioner made in the original case (No. 12940). In response to it the Court then said: "Petitioner also argues that fatal error was committed in admitting evidence pertaining to certain experiments on dogs and human patients. In our opinion the objection to these experiments, several of which will be mentioned hereafter, goes to their weight only, not to their credibility"; *Carter Products, Inc. v. Federal Trade Commission*, 201 F. 2d 446 (C. A. 9, 1953); see footnote 1, 448.

16. No comment deemed necessary. Comment, if required, will be made during oral argument.

17. Petitioner's contention (Rep. Br. 26a-28a) is a mere reiteration and continuation of its argument that it was denied a fair and impartial hearing. In this connection, it might be noted that in the original case (R. 12940) petitioner contended that his cross-examination of Dr. Bollman was restricted by reason of the fact that he was not permitted to ask the following question: "Whether, functionally, man and dog react to the same stimuli in the same manner." This Court agreed with petitioner's contention and held that the cross-examination of Dr. Bollman had been unjustifiably restricted by the examiner and this together with other restrictions and cross-examination resulted in the Court vacating the order to cease and desist. On remand in the instant matter when Dr. Bollman was on the stand, for some reason best known to petitioner, it did not ask Dr. Bollman this particular question.

18. The contention of petitioner (Rep. Br. 28a-30a) is that the Commission adhered to the report and recommendation of the examiner and was misled into making findings based upon the misstatements of the examiner in his original report. A complete reply to this contention of petitioner is the statement made by the Commission in its decision, which is as follows: ". . . and the matter came on for hearing on the merits before the Commission; and the Commission, *having exhaustively considered the entire record*, including the evidence adduced after remand and the briefs and oral arguments of counsel, now finds that this proceeding is in the interest of the public and makes its relevant and supplemental findings as to the facts and its conclusions drawn therefrom the same to be in lieu of its decision of March 28, 1951" (R. 15373, Vol. I, 267) (emphasis supplied).

Petitioner contends (Rep. Br. 28a) that the examiner in his original report "indulged in the misleading practice of creating a false impression in the Commission's mind that examination of Petitioner's own witnesses disclosed damaging admissions by them." It states that a typical instance of this misleading practice is that the examiner, in his original report on the testimony of Dr. Killian, cited the record containing the testimony of Dr. Ivy.

Paragraph 374 of the examiner's original report (R. 12940, Vol. I, 215-216) to which petitioner refers, is the examiner's report on Dr. Killian's testimony in reference to his first condition. All references to the record made by the examiner in this paragraph, except the first, were to the testimony of Dr. Killian. This report of the examiner definitely establishes the fact that *Dr. Killian did testify* (R. 12940, Vol. III, 1235-1236; see also 1249-1250) that the administration of petitioner's laxative pill, when given over a sufficient period of time to produce laxation as set forth in his first condition, will not increase the flow of bile. This being true, the incorrect record reference could not possibly have misled the Commission as to the testimony of Dr. Killian. As a matter of fact, the incorrect record reference made by the examiner was to Dr. Ivy's testimony and the reading of that testimony establishes the fact that Dr. Ivy also testified to the same effect as did Dr. Killian.

In an administrative procedure in which the examiner merely files a report and recommendation and has no authority and does not make any final determination of the issues, as in the instant case, any possible bias and prejudice of the examiner is immaterial.

While we feel confident that the only issues properly before the Court at this time, with reference to the false and misleading representations contained in the petitioner's advertising, are those which relate specifically to the production or flow of bile, nevertheless, the Commission's findings, as well as the injunctive provisions of the order based thereon, which concern the other misrepresentations made by petitioner, are supported by substantial evidence.

1. That the product, "Carter's Little Liver Pills," represents a fundamental principle of nature in self-treatment (R. 12940, Vol. I, 388-389); id. 896 (Dr. Lopez, petitioner's witness); id. 897 (Dr. Avrack, petitioner's witness); id. 899 (Dr. Whittemore, petitioner's witness); id. Vol. III, 931 (Dr. Leader, petitioner's witness); id. 932 (Dr. Dorman, petitioner's witness); id. 933, 934 (Dr. Sanford, petitioner's witness); id. 936 (Dr. Boyd, petitioner's witness)).

2. That said preparation will bring on or restore regularity of bowel movement, or is a cure, remedy, or competent or effective treatment for constipation, or has any beneficial value in the treatment of any of the symptoms thereof in excess of temporary relief afforded by its laxative action (R. 12940, Vol. II, 622, 649, 695, 900; R. 15373, Vol. I, 387; id. Vol. II, 695, 719, 722; see also Res. Br. 14-15).

3. That said preparation does not contain strong medicines (R. 12940, Vol. I, 350, 464, id. Vol. II, 929-930; id. Vol. III, 934 (Dr. Sanford, petitioner's witness); R. 15373, Vol. II, 648).

4. That said preparation is unqualifiedly safe (R. 12940, Vol. I, 359, 361-362; R. 15373, Vol. I, 361).

5. That said preparation is an effective treatment for sluggish liver function or that it will have any therapeutic action on any condition, disease or disorder of the liver (R. 12940, Vol. I, 366; id. Vol. II, 549; and id. Vol. II, 689-690). See also Res. Br. 11.)

6. That said preparation will provide two-way relief or that it possesses therapeutic properties in addition to those afforded by laxative action (R. 12940, Vol. I, 387-388; R. 15373, Vol. II, 649).

7. That said preparation will cause a proper flow of or beneficially affect, the gastric juices or digestive juices or lessen food decay (R. 12940, Vol. I, 379; id. II, 672-673; R. 15373, Vol. II, 622).

8. That said preparation is based on the fundamental principle of the operation of the digestive system (R. 12940, Vol. I, 378-379; id. II, 691; R. 15373, Vol. II, 628).

9. That said preparation will help food digestion, or regulate digestion or the digestive system (R. 12940, Vol. I, 379; id. II, 691; R. 15373, Vol. II, 628; see also R. 12940, Vol. VIII, 1560-1562; R. 15373, Vol. II, 622).

10. That said preparation will have any influence in inducing a state of "bounce," vigor or well-being except in those instances where a lack thereof is due solely to constipation (R. 15373, Vol. II, 622-623; id. Vol. III, 934).

11. That constipation poisons the body (R. 15373, Vol. II, 623, id. Vol. III, 945, Dr. Sanford, petitioner's witness).

12. That said preparation has any value in the treatment of headache, ugly complexion, bad breath, coated tongue, or a bad taste in the mouth, or for those conditions in which an individual feels "Down-and-out," "blue," etc., in excess of such temporary relief thereof as may be afforded by an evacuation of the bowels in those cases in which such symptoms or conditions are associated with and caused by constipation (R. 15373, Vol. I, 383; id. III, 934-935; R. 12940, Vol. III, 944-945).

13. That said preparation is a competent or effective treatment for indigestion or retarded digestion (R. 15373, Vol. I, 378-379; id. Vol. IV, 1560-1562).

14. That said preparation is a competent or effective treatment for biliousness (R. 12940, Vol. II, 691-692; R. 15373, Vol. I, 397-398).

#### CONCLUSION

The Commission, therefore, prays that the petition to review be dismissed and that the Court enter a decree affirming the

Commission's order to cease and desist and commanding petitioner to obey the same and comply therewith.

Respectfully submitted.

EARL W. KINTNER,

*General Counsel.*

JAMES E. CORKEY,

*Assistant General Counsel.*

JNO. W. CARTER, JR.,

FLETCHER G. COHN,

*Attorneys,*

*Attorneys for Federal Trade Commission.*

WASHINGTON, D. C., DECEMBER 30, 1957.

No. 15395

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United States  
Court of Appeals  
for the Ninth Circuit

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MILTON E. DAM and EVERETT S. DAM, Co-partners Doing Business Under the Firm Name and Style of DAM BROTHERS,

Appellants.

vs.

GENERAL ELECTRIC COMPANY, a Corporation,

Appellee.

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Transcript of Record

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Appeal from the United States District Court for the  
Eastern District of Washington  
Northern Division.

FILED

APR 24 1957

PAUL P. O'BRIEN, CLERK

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No. 15395

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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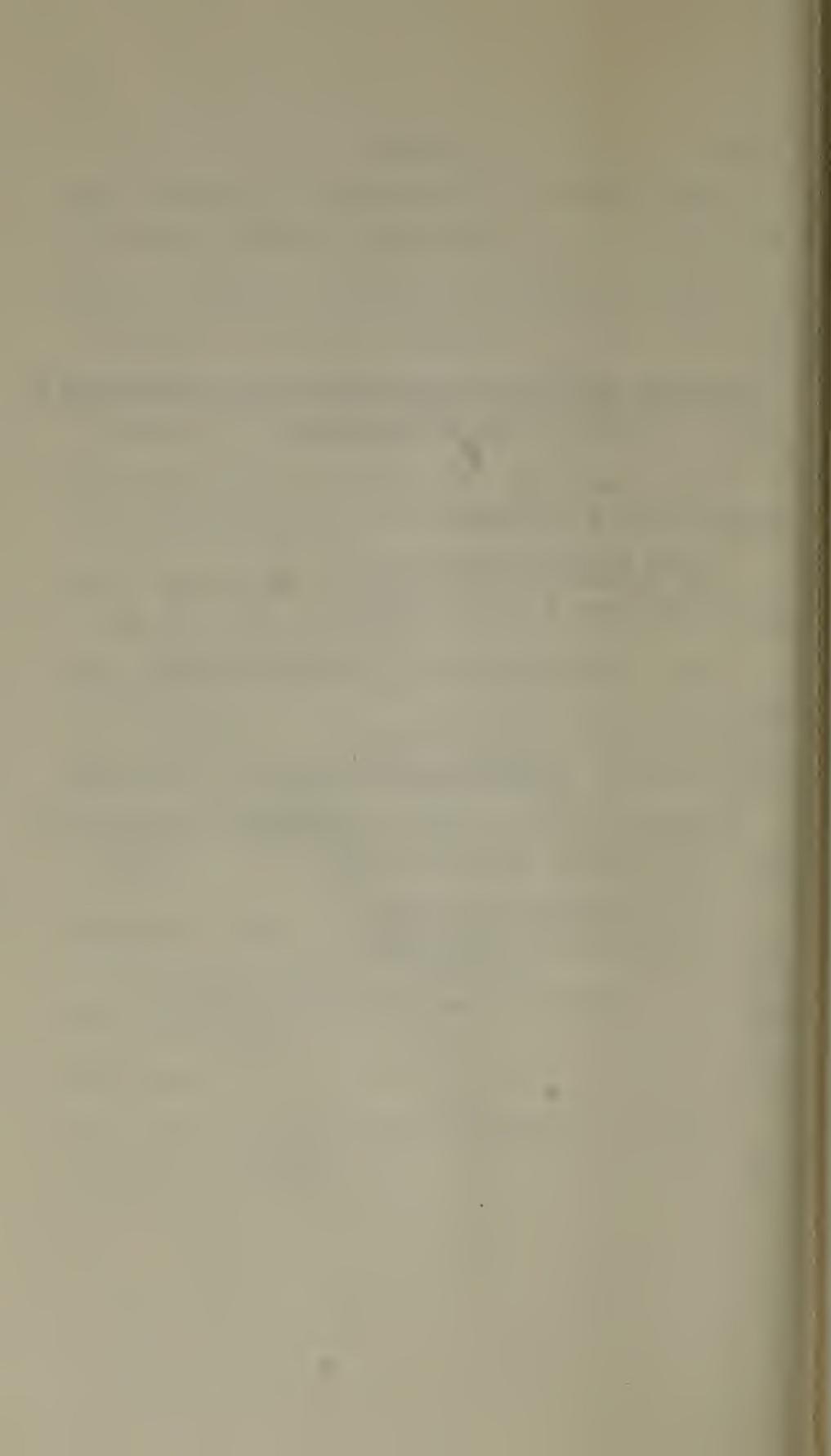
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NAMES AND ADDRESSES OF ATTORNEYS  
OF RECORD

PHIPPS & PHIPPS,  
223 Rookery Building,  
Spokane 1, Washington,  
Attorneys for Plaintiff-Appellant.

WILLIAM W. GODWARD,  
EDWIN E. HUDDLESON, JR.,  
COOLEY, CROWLEY, GAITHER, GODWARD,  
CASTRO & HUDDLESON,  
333 Montgomery Street,  
San Francisco 4, Calif.,  
Attorneys for Defendant-Appellee.



In the United States District Court, Eastern District of the State of Washington, Northern Division, Spokane, Washington

No. 1036

MILTON E. DAM and EVERETT S. DAM, Co-Partners Doing Business Under the Firm Name and Style of DAM BROTHERS,

Plaintiffs,

vs.

GENERAL ELECTRIC COMPANY, a Foreign Corporation; AMERICAN POWER & LIGHT COMPANY, a Foreign Corporation; ELECTRIC BOND & SHARE COMPANY, a Foreign Corporation,

Defendants.

### COMPLAINT

Come now the plaintiffs, Milton E. Dam and Everett S. Dam and for cause of action against the above defendants complain and allege as follows:

#### I.

That the Federal District Court obtains original jurisdiction in this case by reason of Federal Statute, 28 U.S.C.A. Pr. 1332, in that the parties have a diversity of citizenship and the amount involved exceeds the sum of Three Thousand (\$3,000.00) Dollars, exclusive of interests and costs.

#### II.

That at all times hereinafter mentioned the Plaintiffs Milton E. Dam and Everett S. Dam were and

now are partners doing business under the firm name and style of Dam Brothers, formed in 1905, at Seattle, Washington. [1\*]

### III.

That the Defendant, General Electric Company, is a corporation incorporated under and by virtue of the laws of the State of New York, April 15, 1892, with its principal place of business in Schenectady, New York. That it is doing business in the State of Washington.

### IV.

That the Defendant, American Power & Light Company, is a corporation incorporated under and by virtue of the laws of the State of Maine, September 20, 1909, with its principal place of business in New York City, New York. That it is doing business in the State of Washington.

That the American Power & Light Company owns all the common stock of its dummy holding company, the Washington Irrigation & Development Company, a Washington Company, with a legal office registered for the State of Washington, at Vancouver, Washington.

### V.

That the Defendant, Electric Bond & Share Company, is a corporation incorporated under and by virtue of the laws of the State of New York, February 27, 1905, with its principal place of business in New York City, New York. [2]

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\*Page numbering appearing at foot of page of original Certified Transcript of Record.

## VI.

## Dam Brothers

That Dam Brothers had been interested and active in the early irrigation and land development in the Columbia River Basin area during the 1890's. Becoming actively interested in the undeveloped valley on the Columbia River at Priest Rapids, where they had practical ideas for the irrigation and power development of their proposed project. By the spring of 1913 they had completed sufficient engineering and investigations, employing some of the Nation's most able and well-known engineers and experts, which determined the feasibility of plans for the construction of the irrigation and power development works for the valley. Constituting the large level body of land adjacent to and lying between the Columbia River and the Saddle Mountains at Priest Rapids, named by them "The Priest Rapids Highlands," comprising about 135,000 Acres of the highest quality irrigable lands in the state.

## VII.

That the Dam Brothers had acquired and controlled a large acreage of the raw sagebrush land which would be irrigated by their Land, Irrigation and Power Project, "The Priest Rapids Highlands Project."

## VIII.

That they organized the Priest Rapids Landowners Association, of the privately owned lands, up-

wards of One Thousand in number, which represented about fifty per cent of the total acreage of the project.

## IX.

That the Dam Brothers undertook and accomplished necessary and favorable changes in the Washington State Irrigation District laws during the winter sessions of the 1911 and 1913 State Legislature, for their proposed project at Priest [3] Rapids.

## X.

That the plaintiffs helped obtain large appropriations from the Washington State legislature for the State Geologist in order for the State to receive matching funds from the United States Government for geological surveys in the State of Washington. Which survey included the first topographical map covering the Priest Rapids area. Furnishing defendants copies of advanced sheets of the 25-foot contour maps, long before publication of the valuable engineering data.

## XI.

That the Dam Brothers engineering and investigations included every phase of their land, power and irrigation development, for a practical, modern and successful development. Not only the preliminaries and construction, but for the development and production of the lands, with studies and plans covering scientific crop growing for the long mild climate on the Priest Rapids Highlands. The studies and plans for industrializing the crops, processin

lants and marketing, etc. With introduction of the  
rst mechanized equipment for irrigation farming.

### XII.

That the Dam Brothers had worked out the trans-  
ortation system for the Priest Rapids Highlands,  
ncluding construction of the Chicago, Milwaukee

St. Paul Railroad to the valley, with electrified  
eederers covering the Highlands. Construction of an  
xtension of the telephone and telegraph lines from  
Everly and Yakima to the valley and the all-electric  
ity to be built at the dam.

### XIII.

That the Dam Brothers had interested financially,  
friends and interests who were ready to colonize the  
urplus lands with experienced and financially able  
farmers who desired the mild climate, high-class  
land and the many attractive features in prospect  
or the general development of the proposed project  
at Priest Rapids. [4]

Contractors were ready to accept Priest Rapids  
Highlands Irrigation District Gold Bonds for the  
construction of the proposed project.

### XIV.

That the Dam Brothers undertook all of the work  
and paid for all of the costs of the proposed de-  
velopment plans. They had the full confidence of the  
landowners, the Federal, State and Civic authori-  
ties, with their moral support and desire to see the  
Dam Brothers project constructed.

## XV.

That it was just at this period, the spring of 1813, that the above conditions and circumstance prompted the General Electric and Electric Bond & Share interests, the world's largest electrical group to make overtures to Dam Brothers which resulted in the formation of a joint adventure, April, 1913 at the offices of the president of the Electric Bond & Share Company, 71 Broadway, New York, N. Y.

## XVI.

That the General Electric Company organized the Electric Bond & Share Company in 1905 for the following purposes: (1) To realize on various securities acquired in selling its equipment. (2) Obtain proprietary stake in promising young industry (3) To advance sales of its equipment. That the General Electric Company increased its capital and broadened its field of operations until it had grown to be the world's largest manufacturer of electrical equipment, under leadership of the founder, Mr. Charles A. Coffin.

## XVII.

## Electric Bond and Share

That the Defendant, Electric Bond and Share Company, was 100% wholly owned by General Electric Company from inception in 1905 to 1925. Soon after 1925 the General Electric Company distributed the Electric Bond and Share common stock among the stockholders of the General Electric [5] Company.

## XVIII.

## American Power &amp; Light Company

That the Defendant, American Power & Light Company, was organized by Electric Bond and Share Company for purpose of acquiring securities of companies operating or controlling electric power and light, gas, railways, water works, and other public utility properties, which became the largest subholding company in the Electric Bond & Share system, with assets of approximately 500 millions of Dollars by the year 1929. That from May, 1917, until November, 1935, American Power & Light Company did not have a single employee of its own and was wholly under Electric Bond's domination.

## XIX.

## Washington Irrigation &amp; Development Company

That the Washington Irrigation & Development Company was organized in 1910 for the Electric Bond and Share Company to acquire water power-site lands and rights at Priest Rapids on the Columbia River, State of Washington. The entire common stock of the Washington Irrigation & Development Company has been owned, since organization, by American Power & Light Company. The president of American is also president of Washington Irrigation & Development, and the assistant secretary holds that office for both corporations.

## XX.

## General Electric at Priest Rapids

That about 1910 the General Electric Company's subholding and subsidiaries made their first investments in the Priest Rapids Columbia River power site for the purpose of developing a hydroelectric power project. This power site investment of the General Electric-Electric Bond interests consisted of a narrow strip of shore land comprising a small acreage on the west bank of the Columbia River, upstream from the foot of the Rapids, held and owned under a dummy subsidiary holding company, the Washington Irrigation & Development [6] Company.

## XXI.

That during this period and following the first power site investment at Priest Rapids, the Defendants also acquired the power site lands and rights located on the opposite side of the river, the east bank of the Columbia River, extending from the foot of the rapids, upstream to the head of Priest Rapids, a long narrow tract of land, from the Robert E. Strahorn interests, which land and rights Strahorn had held under the name of Columbia Valley Reclamation Company, of Spokane, Washington, a Washington State corporation.

## XXII.

## Restrictive Water Power Laws

That during this time, 1910, the United States Congress passed Water Power legislation under the

restrictive terms and conditions of which said electrical interests considered it impossible for them to finance and construct hydroelectric dams on navigable streams.

### XXIII.

#### Power Trust Era

That the electrical power interests of the country were facing an adverse attitude on the part of the general public and the press and were termed "The Water Power Trust"—which adverse feeling throughout the nation was reflected in the minds of and the attitude of the members of the United States Congress. That this attitude and condition continued and with the restrictive water power laws stagnation of hydroelectric development became so serious by 1913 to the General Electric-Electric Bond & Share electrical interests they became alarmed. Realized that they must formulate some drastic plan to educate the public and the members of the United States Congress to secure a favorable change in the Federal Water Power Laws. [7]

### XXIV.

That the said Defendants were unable to proceed with their development at Priest Rapids for a dam across the Columbia River at the foot of the rapids, because of the restrictive water power laws, which power site then constituted the largest possible hydroelectric development in the United States west of Niagara Falls, with the proposed development of

approximately 400,000 primary h.p. and 300,000 secondary h.p.

## XXV.

### Electric Bond & Share Concerned

That during this period, Sidney Z. Mitchell, president of the Electric Bond & Share Company, 100% owned by the General Electric Company, became aware of and greatly concerned regarding the Dam Brothers and their Priest Rapids interests and plans for the development of power, irrigation and land on the east bank of the Columbia River at Priest Rapids. That Mr. Mitchell became much concerned for the following reasons:

- A. That Dam Brothers plans would interfere with the large plans of General Electric-Electric Bond & Share to develop a single high dam at the foot of Priest Rapids.
- B. That said plans of Dam Brothers for power and irrigation did not require Federal approval.
- C. That the combination interests of Dam Brothers could claim full power development rights at Priest Rapids under the law.
- D. That General Electric-Electric Bond & Share had only partial power site lands and rights at Priest Rapids and they anticipated difficulty in acquiring the full rights and lands there, needed to complete their plans for the proposed dam.
- E. That Mr. Mitchell and Mr. Coffin felt that "power people" could not obtain a change in the ob-

ectionable water power laws, but that Dam Brothers with their plans and interests could accomplish t. [8]

## XXVI.

### Dam Brothers Invited to New York

That Mr. Mitchell made overtures to Dam Brothers which continued to April, 1913, and resulted in heir accepting Mr. Mitchell's invitation to go to New York for consultation. During conferences in his private office a complete study was made of the ntire power, irrigation and land situation at Priest Rapids, the Federal Water Power Laws, and the eed for large hydroelectric development, and with urge power users waiting, emphasizing the enormous business it would bring to the General Electric Company.

## XXVII.

### General Electric-Electric Bond-Dam Brothers Form Joint Adventure

That continually during the progress of these onferences Mr. Mitchell explained and extended ommitments to Dam Brothers to accept from the General Electric-Electric Bond & Share interests, hich later did cause Dam Brothers to believe and ecept these many and various attractive commitnents, hereinafter set forth, and a joint adventure as formed with Electric Bond & Share Company t their offices, 71 Broadway, New York, N.Y., for ie development of a greater Priest Rapids project.

## XXVIII.

Plans, Purposes and Commitments  
of Joint Adventure

That it was at this time, April, 1913, agreed Dam Brothers that their plans be abandoned for the development at Priest Rapids and they join the General Electric-Electric Bond substitute plans for a single and full development of the rapids at Priest Rapids, creating a greater development there.

## XXIX.

That Dam Brothers were to help obtain outside additional power site and industrial lands needed to complete the power site holdings at Priest Rapids and which added lands would be turned over to the Electric Bond & Share Company, which would build the dam. With a Priest Rapids Power Company organized and incorporated by them when the federal legislation for a power bill was passed. [9]

## XXX.

That Dam Brothers were to make available records, investigations, field work and knowledge and know how, which would aid the development including natural resources, minerals and operating materials to be used by the prospective power user to be located at Priest Rapids. To be an all electricified city, with no smokestacks.

## XXXI.

That the Dam Brothers and Electric Bond and Share Company would jointly acquire the lar-

body of land, about 55,000 acres which was a part of the Dam Brothers original Priest Rapids project plans so that this new land ownership could be used as a basis and in helping to secure the proposed Federal Water Power Legislation, to permit the building of the dam at Priest Rapids. Help Dam Brothers continue control the private landowners during the legislative period, and to protect said Dam Brothers' plans for irrigation as irrigation was the first lawful use of the power to be developed.

### XXXII.

That Dam Brothers, with their power and irrigation plans and extensive knowledge of irrigation farming, with their foremost standing in the west with prominent people, and the Priest Rapids Landowners Association, organized by Dam Brothers in 1911, could help obtain passage of a Federal Water Power Bill in Congress to permit Electric Bond & Share to build a dam at Priest Rapids, and it was greed and expected that this could be accomplished within the next two sessions of the United States Congress.

### XXXIII.

That Dam Brothers were to help educate and seek support of their Federal, State, County and Civic official friends, to insure support of the proposed and long-needed Federal water power legislation for the Priest Rapids dam. That the new greater Priest Rapids Power, Irrigation and Land Development Plans justified the federal legislation, emphasizing the irrigation project and the manufacture of agri-

cultural fertilizer as then being produced in [10] Europe.

#### XXXIV.

##### General Electric Anxious for Priest Rapids

That with a favorable change of the water power laws the Defendants would start at once to build the dam at Priest Rapids. That the General Electric Bond & Share interests were then anxious and ready to build the dam. That the financing and the sale of the power were no problems to them. Mr. Mitchell represented that the great General Electric Company was the largest electrical equipment manufacturing concern in the world; that they owned the Electric Bond & Share Company, and were behind its development plans. That Mr. Charles A. Coffin, then chairman of the Board of Directors of General Electric, was anxious to see Priest Rapids developed, which was later confirmed by the president of said corporation.

#### XXXV.

##### Commitments by Defendants

That the commitments of the General Electric Bond & Share interests at said time included the following:

A. That Dam Brothers would receive Five Hundred Thousand (\$500,000.00) Dollars of the common stock of the Priest Rapids Power Company which would be incorporated for about \$40,000,000.00 when the water power bill passed Congress.

B. That Dam Brothers were to own a large percentage of the land holding syndicate to be formed at once and purchase the approximately 55,000 acres of railroad-owned sagebrush lands, with the syndicate to be limited to and comprise the Dam Brothers, the Electric Bond & Share Company, with a few of their officials who would help in the Priest Rapids work.

C. That Dam Brothers were to have ten per cent (10%) interest in the Townsite-Terminal Company, to include industrial, business, residential and terminal property company operations. The operating companies to be incorporated when the power company was formed. [11]

D. That Dam Brothers were to receive the same division of ten (10%) per cent interest in various other syndicates and companies to be organized and acquire natural resources and minerals, etc. in connection with the Priest Rapids development. That there was need for construction materials as well as raw operating materials and minerals for power users which must be available to use with the power contracts.

E. That thereafter Defendants would furnish the funds for the various activities and expenses during the preconstruction period and the legislative work at Washington. That with the passage by the United States Congress of the Water Power Bill, the Electric Bond & Share Company would at once start all the activities at Priest Rapids and the commitments would all then be taken care of together with any

other unsettled or matters to be adjusted by them with Plaintiffs.

### XXXVI.

#### Land Purchase Feature of Joint Adventure Agreement

That during the conferences in New York in April, 1913, it was agreed that Electric Bond & Share-Dam Brothers would purchase from the single ownership some 55,000 acres of sagebrush land-grant railroad lands under and part of the original plans of Dam Brothers for irrigation adjacent to the Priest Rapids power site, on the east bank of the Columbia River. Extending back about thirty miles eastward and situated between the Columbia River on the west and south, and the Saddle Mountains on the north and east. Constituting a large, level, table-like plateau thirty miles long by four to twelve miles wide, comprising about 135,000 acres of the highest quality, volcanic ash sagebrush land—needing only irrigation water to produce every crop of the temperate zone, and equal to the best irrigated lands of the State of Washington. [12]

### XXXVII.

That it was further agreed by Electric Bond & Share that the Dam Brothers would undertake, carry on and control the land development, and the irrigation project, sale and disposition of the said 55,000 acres of land to be purchased by the syndicate. Which purchase of land ownership with the irrigation plans were necessary as the basis for securing favorable water power legislation for a dam

to be built at Priest Rapids by the General Electric-Electric Bond & Share interests.

### XXXVIII.

#### Land Syndicate Formed

That a land syndicate was formed during the said New York conferences and was part of the commitments and agreement of Electric Bond & Share and Dam Brothers with the division of undivided ownership, 30 per cent ownership for Dam Brothers, and 70 per cent ownership for Electric Bond & Share. Which 70 per cent undivided portion was divided by Mr. Mitchell, 25 per cent for Electric Bond & Share Company, and the balance of 45 per cent undivided ownership portion for some of the head officials of Electric Bond & Share-General Electric who would be close to the work for development of Priest Rapids projects.

### XXXIX.

That Mr. Mitchell agreed upon his own voluntary commitments for Electric Bond & Share-General Electric interests that at all times the 30 per cent interest of Dam Brothers and the 25 per cent owned by Electric Bond & Share would be voted as one unit, controlling, so that no acts or policies would be made by the syndicate unless the one unit ownership (55%) agreed on the proposed action or policy, so that Dam Brothers' minority interest of 30 per cent would actually constitute a one-half voting unit position.

## XL.

That when said ownership of the land had served its purpose during the Federal water power legislation, that upon passage of the [13] bill, it was agreed by Mr. Mitchell that Electric Bond & Share interests would release their unit control position of the land syndicate, and that Dam Brothers would take over the full management of the lands in regard to its disposition and policy. That the securing of a water power bill for Priest Rapids dam would compensate them fully and that Dam Brothers should receive the major financial benefit from the sale of the syndicate lands as part of the General Electric-Electric Bond & Share fulfillment of their joint adventure commitments to Dam Brothers.

## XLI.

That another purpose for the purchase by the partnership of the 55,000 acres of land was to prevent some outside interests from acquiring title to this large body of land adjacent to Priest Rapids and interfering with the General Electric-Electric Bond & Share-Dam Brothers new joint plans for a one-power development with a dam at the foot of Priest Rapids, and the irrigation project.

## XLII.

## 55,000 Acre Land Purchase

That the actual purchase of the 55,000 acres of land was carried out by Mr. Mitchell for the syndicate, immediately following the conclusion of the April, 1913, conference and formation of the joint

adventure agreement between Electric Bond & Share and Dam Brothers at their head office in New York City at 71 Broadway.

### XLIII.

#### Large Acreage Added to Townsite

That when the decision was made at the conference to acquire the 55,000 acres of railroad grant lands, and form a syndicate of the Electric Bond & Share-Dam Brothers, it was called to Mr. Mitchell's attention by Dam Brothers that the approximate 55,000 acres of land to be acquired included considerable acreage adjoining the power site and flood lands held by the power rights holding company, the Washington Irrigation & Development Company. That this land [14] bordering the power site and flood land should be transferred from the Land Holding Syndicate to the said company for the proposed power development and townsite, to be held until the water power bill passed in the United States Congress.

### XLIV.

That it was also pointed out to Mr. Mitchell by Dam Brothers that the suggested transfer of these border lands to the power site holding company would add to the showing when filing for the permit for the Priest Rapids dam, with the government. Said lands were transferred from the land holding syndicate to the Washington Irrigation & Development Company, at a later date following the said purchase of the railroad lands. The lands have since then been held and are still a part of the assets of the

said power site holding company for the Priest Rapids development. And constitute one of the claims by the partners, Dam Brothers, against the said defendants as part of the April, 1913, partnership agreement.

#### XLV.

#### Tufa Deposit Asset

That Dam Brothers also invited attention to Electric Bond & Share when suggesting transfer of the townsite border lands to the power site holding company, the existence of a mineral "Tufa," a form of natural cement, on Section 23, Township 15 North Range 23, EWM., about 640 acres of land. Locate near the head of Priest Rapids, Grant County, available for construction without transportation cost.

#### XLVI.

That this Tufa material was valuable for the irrigation works, for building material and concrete construction where limited pressures existed. That the section of Tufa land should also be held by the power-townsitc land holding company, to be transferred to a "Tufa" Natural Cement Company development organization, when the water power bill was passed and the power company formed to build the dam at Priest Rapids. To supply the different projects there. [15]

#### XLVII.

#### Tufa Deposit Interests General Electric

That during New York visits by plaintiffs, Frederick G. Sykes, president of American Power &

Light Company, and Mr. Edwin W. Rice, Jr., president of General Electric Company, both expressed interest in such a natural mineral deposit located right at Priest Rapids. Stating that because of the fact that the Tufa material was so important to the irrigation and land development, and that Dam Brothers had expected to use the Tufa in their Priest Rapids development plans, that Dam Brothers should have the management of the Tufa development as well as a major interest in the syndicate ownership and profits to be derived therefrom. Which joint suggestion by General Electric and American Power & Light officials was later agreed to by Mr. Mitchell, president of Electric Bond.

## XLVIII.

### Water Power Legislation December, 1913

That immediately after the date of the said agreement partnership, April, 1913, the Dam Brothers started on the agreed work that they would undertake to help secure the federal legislation for a dam at Priest Rapids. With the result that the water power legislation was introduced in the United States Congress during the 2nd Session of the 63rd Congress, December, 1913.

## XLIX.

### Water Power Bill Fight

That it was expected by all concerned that a water power bill for the Priest Rapids dam could be obtained during the coming two sessions of Congress,

within 18 months from that time. But the General Electric-Electric Bond & Share made unauthorized radical and controversial changes in the water power legislative plans, without the knowledge or consent of plaintiffs, which changes resulted in the water power bill not being passed by Congress until March, 1920—seven costly years after the legislation was introduced in Congress. [16]

## L.

### Seven-Year Delay in Passage of Water Power Bill

That the delay of seven years in securing said federal water power legislation was caused by General Electric-Electric Bond & Share changing the agreed plans for a water power bill which could have been passed in Congress within two sessions, without the knowledge or consent of Dam Brothers and constituted a breach of their agreement with plaintiffs, namely:

1. That the Electric Bond & Share substitute the plan to have a bill introduced and passed by Congress for a dam at Priest Rapids only, with a substitute plan of Electric Bond & Share for two water power bills, covering all of the United States, one bill for nonnavigable and one for navigable streams

2. Further, by adhering stubbornly and continually for impractical, impossible and illogical terms for the water power bill, including the demand for 99-year tenure instead of 50 years which was finally accepted, and which tenure has proven satisfactory for financing and building of hydroelectric dams

under Federal Water Power control, now for the past thirty years, following the passage of the Bill in March, 1920.

### LI.

That the resultant delay of seven years in getting the Electric Bond & Share substitute water power legislation passed by the United States Congress caused added and heavy burdens to Dam Brothers.

### LII.

That the land owned by the General Electric-Electric Bond & Share and Dam Brothers land holding syndicate-company was used continually in the arguments presented to Congress for securing the water power legislation, during the entire period from the first introduction in the 2nd session of the 63rd Congress, December, 1913, until and including the last arguments before the 2nd session of the 66th Congress when the Water Power Bill passed, March, 1920. The Act was signed by the President in June and became law. [17]

### LIII.

That the said Land holdings of the partnership, the ownership, and the necessary power for the pumping plant of the Priest Rapids Highlands Project Irrigation system, were all used before Congress year after year to obtain the enactment of favorable water power laws. Always presenting the same arguments, both on the floor and in the hearings of the different committees of the United States Senate and House.

## LIV.

That with the passage of a workable and favorable water power bill enacted into law, the General-Electric Bond & Share interests were highly elated and satisfied although the legislation had taken seven long years to accomplish. That the land and the irrigation project at Priest Rapids had served its purpose for them, in helping to obtain passage of this water power bill.

## LV.

General Electric Subsidiary Files  
for Priest Rapids Dam Permit

That the newly created Federal Power Commission was formed and the application for the permit for the dam at Priest Rapids was filed by the General Electric-Electric Bond & Share interests in the name of the said Washington Irrigation & Development Company, the power rights and townsite land holding company for the Priest Rapids dam site, which holding company was 100% owned by the American Power & Light Company, which in turn was then controlled by the Electric Bond & Share Company, which was then owned 100% by the General Electric Company.

## LVI.

Conspiracy and Breach of Contract

That certain events which took place during 1920 and 1921 indicated that there had existed a conspiracy on the part of the power holding company,

the Washington Irrigation and Development Company and the Electric Bond & Share and their head officials as representative agents to deprive, damage and harm the Dam Brothers in regard [18] to the Land Holding Syndicate-Company, Dam Brothers interests and assets at Priest Rapids. By the acts of the said electric interests-partners and associates, in that these partners of Dam Brothers, committed acts of conspiracy, conniving and misrepresentation, by undertaking secretly to dispose of the entire land holdings of approximately 50,000 Acres owned by the General Electric-Electric Bond Share interests-Dam Brothers land holding syndicate-company, without the knowledge, counsel or consideration of their partner-associates Dam Brothers. In complete violation of the 1913 Joint Adventure Agreement, thus constituting a major breach of contract. This act of conspiracy by the Defendants through their officers immediately followed the passage of the Water Power Bill March, 1920, and would have deprived Dam Brothers of benefits to be derived by said Dam Brothers as a part of the said 1913 Agreement. The secret land sale was blocked by Dam Brothers and the said transaction was then dropped by the Defendants.

## LVII.

### Lands Become Valuable Syndicate Incorporated

That the General Electric-Electric Bond & Share interests had so bungled and mismanaged the legislative work for the water power bill that it was by

1916 involved in serious controversial debate in Congress, and the land holdings of the said syndicate had become so important in consideration of the legislation and its prospective agricultural value that Mr. Mitchell thought it best to incorporate the land holding syndicate. The Columbia Highlands Company was therefore incorporated in 1916 and the syndicate transferred title of the entire land holdings to the new land holding corporation-syndicate.

## LVIII.

That the capital stock of the Columbia Highlands Company was distributed to the representative undivided ownership interests with the same percentage of ownership as was owned and held by them in the [19] land holding syndicate of April 1913. With the assurances of Mr. Mitchell to Dam Brothers for the General Electric-Electric Bond & Share insuring Dam Brothers the same commitments, provisions, and conditions as agreed by Mr. Mitchell in 1913, pertaining to the Dam Brothers control and other features in connection with the land, its sale, disposition, and policies when the Water Power bill was passed and became a law.

## LIX.

Electric Bond & Share Use Dam Brothers  
for New and Added Requirements

That the General Electric-Electric Bond & Share interests, with the water power bill a law, which would permit the development of the Priest Rapids

project, outlined and called upon Dam Brothers to further help and assist them on a program which included the obtaining of the water power permit, and the issuance of the license for the dam at Priest Rapids, investigations and locating additional raw operating materials and minerals which would be required by the prospective power users to be located at Priest Rapids.

## LX.

### Permit Issued for Dam

That on March 3, 1921, the Permit was issued for the dam at Priest Rapids by the Federal Power Commission, as power project No. 3, and the power holding company undertook the diamond drilling of Priest Rapids dam foundations, and Electric Bond & Share Company proceeded to complete the engineering work and plans in its own engineering offices at 71 Broadway, New York City, so that a contract could be awarded for the construction of the said dam.

## LXI.

That June, 1922, saw the foundations determined and the field work at Priest Rapids and the engineering plans completed for the dam. Whereupon, Mr. Mitchell desired and strongly emphasized the importance then of Dam Brothers undertaking and completing the irrigation [20] engineering for the Priest Rapids Highlands project to irrigate the approximately 135,000 acres, including the General Electric-Electric Bond and Share-Dam Brothers and holding-syndicate-company, about 50,000 Acres,

while Electric Bond prepared to let the contract for the building of the dam at Priest Rapids.

## LXII.

### Dam Brothers Buy Highlands Lands

That the Dam Brothers in view of the definitely assured early starting of the dam construction at Priest Rapids and the recent land sale conspiracy by Defendants in their attempt to deprive the Dam Brothers of their rights, it was believed by Dam Brothers that they should acquire the syndicate land holdings in order to protect the irrigation project as well as their interests at Priest Rapids. That as the result of conferences during June, 1922, in New York, reviewing the entire Priest Rapids project and allied features, Mr. Mitchell recommitted the General Electric-Electric Bond and Share commitments, and others added due to Defendants' desire for new and added help from Dam Brothers, a land purchase agreement was made between Mr. Mitchell and Dam Brothers, just 9 years after the Joint Adventure agreement of 1913, in the same private office of Mr. Sidney Z. Mitchell, president of Electric Bond, 71 Broadway, New York.

## LXIII.

That a cash down payment of a considerable sum was made to Mr. Mitchell personally by Dam Brothers, on the Land Purchase Agreement. That this payment was made after the positive assurance of Mr. Mitchell that General Electric-Electric Bon-

were ready to get started right away for letting the construction contract for the dam at Priest Rapids. That Mr. Mitchell was so confident of starting the construction of the dam right away that he was offered to accept one half of the substantial cash-down payment by Dam Brothers on the land purchase comprising the entire land holdings of the syndicate-company, with the second half or balance of the cash-down [21] payment to be paid in September by which time he stated evidence would be in hand for Dam Brothers of the starting of the long awaited dam construction at Priest Rapids.

## LXIV.

### Dam Brothers Complete Engineering

That Plaintiffs on return West from the June, 1922, New York conferences with Electric Bond & Share, took immediate steps and followed out Mr. Mitchell's desires and expended large sums of money for engineering work to complete the irrigation system plans ready for turning over to the contractor for construction. That the month of September came and passed with Dam Brothers busy with the Priest Rapids work of carrying out the engineering and other general matters resulting from the June meeting in New York. Still there was no sign of evidence in hand of the General Electric-Electric Bond & Share interests starting actual construction work on the dam as assured and committed by Defendants in June.

## LXV.

## Electric Bond Fails to Start on Dam

That when Dam Brothers delayed to make the second half of the cash-down payment during september because Defendants failed to start the construction on the Priest Rapids dam, an official of the General Electric-Electric Bond & Share Western operating subsidiary utilities requested a meeting with Dam Brothers in their Seattle offices; a an appointed time arrived accompanied by his General Counsel, who was also a director of the Pries Rapids holding companies and the Western subsidiaries of General Electric-Electric Bond & Share interests.

## LXVI.

## General Electric Representatives Call

That these two high officials as agents of Genera Electric-Electric Bond & Share interests, used their time at this meeting with both Dam Brothers pres ent in their private offices, to promise, urge [22] and argue that Mr. Mitchell was getting ready a last to start the Priest Rapids dam, that Dan Brothers release said second half of the cash-dow payment so that the land holding syndicate-com pany could pay off the mortgage soon due, one of ficial had just returned from New York and there fore he knew that Mr. Mitchell would soon start on the dam. That they would not make the trip to Dam Brothers' Seattle offices and make such claim if they did not know and believe Mr. Mitchell would

actually start construction this time sure. That to show evidence of good faith they were authorized from New York offices to grant an extension for one year to Dam Brothers in which to start the annual cash installment payments on the purchase agreement, (1922-June). The payment was later released.

## LXVII.

### Payment Release Disastrous

That these official statements and commitments made by these two high officers of General Electric-Electric Bond & Share's subsidiaries, to Dam Brothers, later proved to be false and misleading, thereby resulting in disastrous repercussions subsequently for the Dam Brothers and from which they never financially recovered. That this was entirely the fault and brought on by General Electric-Electric Bond & Share interests.

## LXVIII.

That with the payment by Dam Brothers of the second half of the substantial down payment for the March, 1923, Directors Meeting (Columbia Highlands Company), obtained from Dam Brothers, it was evidently easy thereafter for the Defendants to obtain annually smaller and nominal amounts from plaintiffs, compared to the first two large cash payments, with offers of annual extensions to Dam Brothers for starting the annual cash installment payments which were to have been made from the actual starting of the dam construction at Priest

Rapids. That these nominal and smaller annual land purchase extensions payments were made by Dam Brothers to Defendants to cover County Taxes, corporate expenses of the syndicate-company [23] land holding company, the Columbia Highlands Company, between 1923 and 1926, and to eliminate stock assessments by the Company.

## LXIX.

### Post License Period 1925-1929

That on March 25, 1925, the Federal Power Commission issued the License for the dam on the Columbia River at Priest Rapids to be constructed by the Electric Bond & Share Company, five years to the month after the passage of the Water Power Bill. That because of mis-management and poor judgment by Defendants several years of valuable time was lost before obtaining the said License.

## LXX.

That the country was in the middle of a ten year electrical boom and industrial prosperity, with the demand for large blocks of hydro-electric power resulting in new power construction and installation all over the United States.

## LXXI.

That everything envisioned by Mr. Charles A. Coffin, head of the great General Electric Company, as pictured to Dam Brothers during the April, 1913, New York conferences, about hydro-electric devel-

opment, new and wonderful uses for electricity, the enormous prospective demand for electrical equipment and products manufactured by General Electric Company, if favorable water power legislation could be secured, all came to pass. And more too, in the way of electro-metallurgical and electro-chemical demands for hydro-electric power and anxious to go to Priest Rapids. Yet, the world's leading electrical interests failed to start construction of the dam at Priest Rapids upon receiving the License from the Government.

## LXXII.

That defendants could have easily financed and constructed said dam, as there were large power users and customers anxious for large blocks of industrial power far exceeding the full possible capacity of the Priest Rapids dam. The worth of the Electric Bond & Share [24] Company, wholly owned by the General Electric Company, increased and mounted from the passage of the Water Power Bill, March, 1920, with the forming and buying of utility companies, domestic and foreign, investments by the Hundreds of Millions of Dollars, as a direct result of the improved water power laws. The origin, the starting in 1913, and need for same based almost entirely upon the plans and work of Dam Brothers; the main purpose of the Joint Adventure formed by them and General Electric-Electric Bond, the successful enactment of the bill which received the valuable and loyal contributions of the Plaintiffs.

## LXXIII.

That the last five years of this most prosperous period in the history of the United States, for privately owned utilities, termed the "Electrical Era," was permitted to pass by the Electric Bond and Share Company by bungling and mismanaged what limited attention they gave the Priest Rapids plans, wasted and dissipated this wonderful opportunity to develop this most favorable water power site, in which the General Electric-Electric Bond had then upwards of \$10,000,000.00 invested.

## LXXIV.

That the General Electric Company had become the world's largest electrical equipment manufacturing concern, having enjoyed enormous business companies, the largest Private Utility Holding Company in the United States according to Government investigations.

## LXXV.

That because of the depression following the 10 year Electrical Boom and prosperity, the government policy of building large hydroelectric dams, and the World War II years with restriction in the use of Capital, Materials and Labor, development by private utilities was not considered favorable. There was continued hopefulness for the conditions to change and construction of dams by the private power companies throughout the United States. [25]

## LXXVI.

## A Major Priest Rapids Asset Ruined

That following cessation of hostilities of World War II the Defendants entered into negotiations in fraud of the rights of Dam Brothers therein by selling the total land holdings of the Syndicate-Company on the Priest Rapids Highlands for a nominal sum, and forever placed said partnership syndicate lands out of the power of the Defendants and Dam Brothers for development and sale. That at all times Dam Brothers served written and verbal notice of their objections to any disposition of the said Syndicate lands, either in whole or in part.

## LXXVII.

That in protesting the said proposed sale of the lands, Dam Brothers sent registered mail notices to the defendant companies, General Electric-Electric Bond and Share, and the Columbia Highlands Company, to serve warning of the Defendants' responsibility and their obligations to Dam Brothers for their vast and substantial various investments and interests at Priest Rapids, holding defendants accountable for full losses, damages, and claims, resulting from the sale of said Syndicate lands, or for any other acts committed by them effecting the Priest Rapids assets without full consideration of Dam Brothers interests.

## LXXVIII.

## Tufa Deposit Sold for Paltry Sum

That said deposit of Tufa was held by the Priest Rapids power site-industrial land holding company,

the Washington Irrigation and Development Company, continually up to about the year 1949, when the Plaintiff learned in the private office of the Western General Counsel for the General Electric-Electric Bond & Share's Pacific Northwest interests who also was president of the said land holding company, that he had just the week before sold the said Tufa deposit land, for thirty-five hundred dollars. The said sale was made by Defendants without consent or knowledge of Dam Brothers. That plaintiff made vigorous oral objections and complaint to said official, for making the said sale and for not consulting Dam Brothers before even negotiating the sale of the Tufa deposit section of land.

### LXXIX.

That the plaintiff was responsible for the Tufa Section of land of about 640 Acres, being originally called to Defendants attention during the first period of the General Electric-Electric Bond & Share Dam Brothers partnership and its transfer to the power site-industrial land holding company, which had since held title to the said Tufa deposit. That this deposit of natural cement formation had always been considered by the partnership formed in 1911 as being an asset that could be used and developed independent of the other Priest Rapids assets, and would have a ready demand upon the open [27] market.

## LXXX.

## Allegation of Performance

That at all times, herein mentioned, without exception, the Dam Brothers fulfilled every pledge, duty and obligation that they were committed to by the Joint Venture agreement with General Electric-Electric Bond and Share. In addition Dam Brothers fulfilled every request by Defendants for discovery, location and investigation, research, laboratory work, and prepared reports therefrom and furnished Defendants, covering numerous raw materials and minerals required by large industrial concerns proposing to locate at Priest Rapids and contract with Defendants for large blocks of electrical power to be produced at Priest Rapids dam.

## LXXXI.

That the General Electric-Electric Bond and Share failed to fulfil any of their commitments to Dam Brothers during the periods mentioned in the complaint, covered by the Joint Adventure agreement made April, 1913, and additional commitments made by the Defendants following the first agreement with Plaintiffs.

## LXXXII.

That the great wealthy General Electric-Electric Bond and Share interests swamped in enormous successful growth, development and profits following the passage of the Water Power Bill in the United States Congress, although neglecting and failing to

build the dam at Priest Rapids after receiving the Government permit, diverted accomplishments of the Joint-Adventure for Defendants sole and separate independent use, benefit and advantage. Which benefit and advantage ran into hundreds of millions of dollars of profit and value, and contributed greatly to Defendants increased worth to over \$2,000,000,000.00 according to Government and private Financial Reports. [28]

### LXXXIII.

That in view of the fact that Defendants recently started to liquidate their utility interests located in the State of Washington, it became evident to plaintiffs that defendants did not intend to develop the Priest Rapids project and therefore a written demand was made on June 14, 1951, for a full settlement in connection with the Priest Rapids project, in response to which defendants have made no reply.

### LXXXIV.

That it was just learned by the plaintiffs that the defendants are giving away the entire Priest Rapid power site holdings, the main part of which property holdings have been held in trust by defendant dummy holding company, the Washington Irrigation & Development Company, since its organization in 1910, of which all its common stock has been held by the American Power & Light Company.

### LXXXV.

That the Defendants have therefore by their own recent actions made the purpose of the joint

adventure agreement incapable of [29] performance.

### LXXXVI.

(1) That as a direct and proximate result of defendants breach of the joint-adventure agreement the plaintiffs have suffered loss and damages as follows:

1. Priest Rapids Power Company common stock .....	\$ 500,000.00
2. 10% Interest Townsite—Terminal Company common stock .....	250,000.00
3. 10% Interest Limestone Company construction supply—chemical works user .....	100,000.00
4. 30% Interest Tufa Natural Ce- ment Company common stock ....	50,000.00
5. Hydro-Chemical Operations-Niag- ara Falls Plant successful Opera- tion (interest holding company)..	90,000.00
6. Strategical Minerals—Raw Ma- terials—Basic items for Major power users—Electro-metallurgi- cal Electro-chemical Industries, including Aluminum Clay-Alunite- Bauxite Deposits (Metals) Iron Ore, Magnesium, alloys (Electric Furnace) Phosphate Rock, Sul- phur, etc. (Chemicals), Coal and Coke (Industries) Timber, So- dium Sulphate (Pulp-Paper- Rayon) .....	300,000.00

7. Land—Syndicate 50,000 Acres (3 rural townsites, completely engineered project), 30% of total profit .....	900,000.00
8. Engineering—135,000 acre project—Irrigation, power, etc.....	250,000.00
9. Private owned lands—Highlands.	750,000.00
10. Offices, laboratory, ranches, equipment, livestock, homes, autos.....	160,000.00
11. Mines, mineral lands, research engineering, professional records, maps and reports.....	200,000.00

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All to plaintiffs damage in the sum of ..... \$3,550,000.00

### LXXXVII.

(2) That as a further direct and proximate result of defendants breach of the joint adventure agreement the plaintiffs have suffered loss and damages as follows:

Said plaintiffs, Dam Brothers, in, and because of said breach of the joint adventure agreement, as alleged, suffered loss of finances and credit; loss of business activities; engineering opportunities and operations;

Loss of business standing and reputation; loss of friends and business association and connections; loss of relationship with prominent Federal, State and Civic Officials; railroad, irrigation, power and

professional men; social, club and community life and standing;

Great mental anguish, worry and suffering and humiliation; that plaintiffs have suffered the above losses and injury for a long period of time and will continue to suffer for the rest of their lives;

That defendants benefited by numerous official business trips and entertainment over a long period of years; use of plaintiffs finances, credit, offices, employees, properties and equipment; use of plaintiffs professional and business records, knowledge, knowhow and time; use of plaintiffs associates and friends, position and public relations;

All to plaintiffs damage in the sum of \$5,000,-000.00 [31]

That the failure of the Defendants during their relationship with the Plaintiffs from the formation of the joint adventure in April, 1913, and up to the present time, to carry out their agreements and commitments with plaintiffs, or at all, and their failure to fully compensate plaintiffs for reimbursements, adjustments, and for services rendered and materials furnished has caused the plaintiffs to suffer damages and losses in the aggregate sum of eight million five hundred fifty thousand (\$8,550-000.00) dollars.

Wherefore plaintiffs pray that they may recover judgment herein against Defendants, and each of them for the total sum of \$8,550,000.00 together with their costs and disbursements herein. For such

other and further relief as to the Court may seem just and proper.

/s/ HARVE H. PHIPPS,  
Attorney for Plaintiffs.

Duly verified.

[Endorsed]: Filed July 16, 1952. [32]

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[Title of District Court and Cause.]

### SUMMONS

To the above-named Defendant, General Electric Company, a foreign corporation:

You are hereby summoned and required to serve upon Harve H. Phipps, plaintiffs' attorney, whose address is 223 Rookery Building, Spokane 1, Washington, an answer to the complaint which is herewith served upon you, within twenty (20) days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

[Seal] /s/ STANLEY D. TAYLOR,  
Clerk of Court.

Date: July 16, 1952.

Return on service of writ attached.

[Endorsed]: Filed July 16, 1952. [33]

[Title of District Court and Cause.]

**MOTION TO DISMISS**

The defendant, American Power & Light Company, moves the Court as follows:

1. To dismiss the action because the complaint fails to state a claim against defendant upon which relief can be granted.
2. To dismiss the action or, in lieu thereof, to quash the return of service of summons on the ground (a) that the defendant is a corporation organized under the laws of Maine and was not and is not subject to service of process within the Eastern District of Washington, nor in the State of Washington; and (b) that the defendant has not been properly served with process in this action, all of which more clearly appears in the affidavit of Howard L. Aller hereto annexed as Exhibit "A."
3. To dismiss the action on the ground that it is in the wrong district because (a) the jurisdiction of this court is invoked solely on the ground of diversity of citizenship and neither all the plaintiffs nor all the defendants reside in the Eastern District of Washington and (b) all the defendants are indispensable parties, and defendants American Power & Light Co. and Electric Bond and Share company are not subject to service of process in the Eastern District [34] of Washington, nor in the State of Washington, all of which more clearly appears in the affidavit of Howard L. Aller hereto

annexed as Exhibit "A" and the motion to dismiss of the defendant, Electric Bond and Share Company, filed herein, and to which reference is hereby made.

/s/ ALAN G. PAINE,

/s/ ALAN P. O'KELLY,

PAINE, LOWE & COFFIN,

Attorneys for Defendant American Power & Light  
Company. [35]

### EXHIBIT "A"

[Title of District Court and Cause.]

### AFFIDAVIT

State of New York,  
County of New York—ss.

Howard L. Aller, being first duly sworn, deposes and says:

1. That he is now, and since November, 1935, has been, the President of American Power & Light Company, a defendant named herein.

2. That American Power & Light Company is a corporation organized and existing under the laws of the State of Maine, having been created under the laws of the said State of Maine on September 20, 1909.

3. That the principal corporate office of American Power & Light Company, is, and during its

entire corporate existence has been, in Augusta, Maine, American Power & Light Company, at all times during which affiant has been its President, has maintained said office in Augusta, Maine, and an office in [36] the City of New York, New York, and at no other place within any state of the United States or any foreign country and specifically has not maintained any place of business whatsoever in the State of Washington.

4. That American Power & Light Company is and always has been a holding company engaged in the business of acquiring by transactions within the State of New York or in interstate commerce, for the purposes of investment and realization upon, the securities of public utility companies operating in various states of the United States, including the State of Washington, and of converting by transactions in New York or in interstate commerce its investments in said securities into other forms of investment in securities and cash. It has never conducted any part of its ordinary and regular business within the State of Washington or been present in the state for the transaction of its regular business.

5. That American Power & Light Company is now, and ever since November 25, 1946, has been, in process of dissolution.

The Securities and Exchange Commission of the United States, acting pursuant to provisions of the Public Utility Holding Company Act of 1935, by

an order dated August 22, 1942, directed that the existence of American Power & Light Company be terminated and said company dissolved. The said order of the Securities and Exchange Commission was contested by it in the United States Circuit Court of Appeals for the First Circuit and in the United States Supreme Court with the result that the said order of dissolution of the Securities and Exchange Commission was upheld and held effective for all purposes. The opinions in the said litigation are set forth at 329 U. S. 90, and 141 F. (2d) [37] 606.

6. That American Power & Light Company owns no property within the State of Washington but does own all of the outstanding Common Stock of The Washington Water Power Company, Washington corporation.

That pursuant to an order of the Securities and Exchange Commission, dated June 6, 1952, and an order of the United States District Court for the District of Maine, Southern Division, dated July 17, 1952, American Power & Light Company will dispose of all of its interests in The Washington Water Power Company.

That American Power & Light Company owns all of the outstanding capital stock and debt securities of Washington Irrigation & Development Company, a Washington corporation whose only assets in the State of Washington are some lands, largely uncultivated and idle, and certain securities of The

Limestone Company, a Washington corporation which owns real estate in the State of Idaho.

That Washington Irrigation & Development Company transacts no business except the incidental leasing of minor portions of its real estate, and such business is entirely separate and different from that conducted by American Power & Light Company. Washington Irrigation & Development Company engages in no business whatsoever on behalf of American Power & Light Company and at no time has Washington Irrigation & Development Company transacted or engaged in business as agent or representative of American Power & Light Company.

That pursuant to an order of the Securities and Exchange Commission, dated June 6, 1952, and an order of the United States District Court for the District of Maine, Southern Division, dated July 17, 1952, American Power & Light Company will dispose of all of its interests in Washington Irrigation & Development Company. [38]

7. That American Power & Light Company has entered into no commercial transactions whatsoever in the State of Washington for the last several years.

8. That the books and records of American Power & Light Company and those of Washington Irrigation & Development Company are separate and distinct.

9. That American Power & Light Company has never qualified as a foreign corporation under the laws of the State of Washington.

That American Power & Light Company has never maintained, appointed or located any officer or managing or general agent in the State of Washington to conduct business for it or to receive service of process on it.

10. That neither a copy of the summons or a copy of the complaint was served upon American Power & Light Company or the affiant or any officer or agent of American Power & Light Company, by a United States Marshal, a United States Deputy Marshal or any person specifically appointed by the Court for that purpose.

/s/ HOWARD L. ALLER.

Subscribed and sworn to before me, a Notary Public in and for the County and State aforesaid, this 31st day of July, 1952.

[Seal]      /s/ FLORENCE O. DEMO,  
Notary Public, State of New  
York.

Term Expires March 30, 1954.

Receipt of copy acknowledged.

[Endorsed]: Filed August 5, 1952. [39]

[Title of District Court and Cause.]

### MOTION TO DISMISS

The defendant, Electric Bond and Share Company, moves the court as follows:

1. To dismiss the action or, in lieu thereof, to quash the return of service of summons on the ground (a) that the defendant is a corporation organized under the laws of New York and was not and is not subject to service of process within the Eastern District of Washington, nor in the State of Washington; and (b) that the defendant has not been properly served with process in this action, all of which more clearly appears in the affidavits of George G. Walker and B. M. Betsch hereto annexed as Exhibits "A" and "B."
2. To dismiss the action on the ground that it is in the wrong district because (a) the jurisdiction of this court is invoked solely on the ground of diversity of citizenship and neither all the plaintiffs nor all the defendants reside in the Eastern District of Washington and (b) all the defendants are indispensable parties, and defendants, American Power & Light Company and Electric Bond and Share Company, are not subject to service of process in the Eastern District of Washington, nor in the State of Washington, all of which more clearly appears in the affidavits of George G. Walker and B. M. [40] Betsch hereto annexed as Exhibits "A" and "B" and the motion to dismiss of the defend-

ant, American Power & Light Company, filed herein and to which reference is hereby made.

/s/ ALAN G. PAINE,

/s/ ALAN P. O'KELLY,

PAINE, LOWE & COFFIN,

Attorneys for Defendant Electric Bond and Share Company. [41]

### EXHIBIT "A"

[Title of District Court and Cause.]

### AFFIDAVIT

State of New York,

County of New York—ss.

George G. Walker, being first duly sworn, deposes and says:

1. That he is now and since November 29, 1944, has been the President of Electric Bond and Share Company, a defendant named herein.

2. That Electric Bond and Share Company is a corporation organized and existing under the laws of the State of New York, having been created under the laws of said State in 1905. [42]

3. That the principal corporate office of Electric Bond and Share Company is, and during its entire corporate existence has been, in the City of New York, New York. Electric Bond and Share Company, at all times during which affiant has been

its President, has maintained said office in the City of New York, New York, and at no other place within any state of the United States or any foreign country, and specifically has never maintained any place of business whatsoever in the State of Washington.

4. That Electric Bond and Share Company is and always has been a holding company and, while affiant has been President of Electric Bond and Share Company, it has never conducted any part of its business within the State of Washington or been present in said State for the transaction of any part of its business.

5. That at all times during which affiant has been President of Electric Bond and Share Company it has owned no property within the State of Washington and owns no securities of any company which does business in the State of Washington.

6. That since February 15, 1950, Electric Bond and Share Company has owned common stock of American Power & Light Company constituting less than 8 per cent of the voting power of the common stock of American Power & Light Company.

7. That no officer or representative of Electric Bond and Share Company has been present within the State of Washington within the last several years and that it has entered into no commercial transactions whatsoever in the State of Washington while affiant has been President of Electric Bond and Share Company. [43]

8. That Electric Bond and Share Company has never qualified as a foreign corporation under the laws of the State of Washington, that while affiant has been President of Electric Bond and Share Company, it has never maintained any office or place of business in the State of Washington or maintained, appointed or located any officer or managing or general agent in the State of Washington to conduct business for it or to receive service of process on it.

9. That neither a copy of the summons nor a copy of the complaint in this case was served upon Electric Bond and Share Company or the affiant or any officer or agent of Electric Bond and Share Company by a United States Marshal, a United States Deputy Marshal, or any person specifically appointed by the court for that purpose, that the only notice of the institution of this suit received by Electric Bond and Share Company was a copy of a purported summons and a complaint which were delivered to it in New York by United States mail, in an envelope bearing the name and return address of the attorney for plaintiffs.

/s/ GEORGE G. WALKER.

Subscribed and sworn to before me, a Notary Public in and for the County and State aforesaid, this 29th day of July, 1952.

[Seal]      /s/ DONALD T. HOWELL,  
                  Notary Public for the State  
                  of New York.

Commission expires March 30, 1953. [44]

## EXHIBIT "B"

[Title of District Court and Cause.]

## AFFIDAVIT

State of New York,  
County of New York—ss.

I, B. M. Betsch, being first duly sworn, depose and say:

1. That I am the Secretary and Treasurer of Electric Bond and Share Company, one of the defendants named herein, and in such capacity have custody of the corporate securities owned by Electric Bond and Share Company.
2. That Electric Bond and Share Company owns 183,050 shares of the capital stock of American Power & Light Company, a defendant named herein.
3. That I have from time to time read financial reports issued by American Power & Light Company and on the basis of such financial reports, American had at December 31, 1951, a total of [45] 2,342,411 shares of capital stock issued and issuable.
4. That the capital stock of American Power & Light Company owned by Electric Bond and Share Company constitutes approximately 7.81% of the voting power of all the capital stock of American Power & Light Company.

5. That the only notice of this suit which Electric Bond and Share Company has received was a purported summons, bearing no signature, to which was attached a copy of the complaint herein; that the said purported summons and copy of complaint were received in my office in an envelope which bore the legend

“From: Harve H. Phipps, Lawer, 223 Rookery Building, Spokane 1, Washington.”

Addressed, “To: Electric Bond & Share Company,  
2 Rector Street, New York City 6, New York.”

that the said envelope and contents were delivered by United States mail.

/s/ B. M. BETSCH.

Subscribed and sworn to before me this 31st day of July, 1952.

[Seal]      /s/ DONALD T. HOWELL,  
                    Notary Public for the State  
                    of New York.

Commission expires March 30, 1953.

Receipt of copy acknowledged.

[Endorsed]: Filed August 5, 1952. [46]

[Title of District Court and Cause.]

## AMENDED COMPLAINT

Come now the plaintiffs and for first cause of action against the above defendants, complain and allege as follows:

### I.

That the Court has jurisdiction of the above-entitled action for the reason that there exists a diversity of citizenship of the parties litigant, the plaintiffs being residents of the State of Washington, and the defendants being foreign corporations, the defendant, General Electric Company, being incorporated under and by virtue of the laws of the State of New York; the defendant, American Power & Light Company, being a corporation incorporated under and by virtue of the laws of the State of Maine, and the defendant, Electric Bond & Share Company, being a corporation incorporated under and by virtue of the laws of the State of New York; that likewise the matter in controversy exceeds the sum of Three Thousand Dollars (\$3,000.00), exclusive of interest and costs; that defendant, General Electric Company, and the defendant, American Power & Light Company, are doing business in the State of Washington, and the defendant, Electric Bond & Share Company, was at all times herein mentioned the agent, servant and representative of the defendant, General Electric Company, and one of the chief instrumentalities and agents, [47] through which said General Elec-

tric Company did business, and said Electric Bond & Share performed for defendant principal, General Electric Company, the acts performed by it as alleged hereinafter.

### II.

That the defendants, General Electric Company and American Power & Light Company, have wholly controlled at all times mentioned herein, the Washington Irrigation & Development Company, a Washington corporation, and said Washington Irrigation & Development Company has been and is, employed and used by said defendant corporations only as a dummy and instrumentality, so that the said defendant corporations could perform their respective businesses through and by it; that prior to, and at the time of the commencement of this action, the said Washington Irrigation & Development Company, was owned and was being used by the American Power & Light Company in the fashion and in accord with the allegations made in this paragraph.

### III.

That plaintiffs had been and were active in the early irrigation and land development in the Columbia River Basin area and particularly in the undeveloped valley on the Columbia River at Priest Rapids prior to the year 1900, and the said brothers, plaintiffs, had in the year 1913 completed engineering surveys and investigation in the said Priest Rapids area which determined the feasibility of plans for the construction of irrigation and power development projects in and about said area; that

the area so described comprises about 135,000 acres of highly irrigable lands in the State of Washington; that plaintiffs had likewise organized the Priest Rapids Land Owners Association comprised of private owners of lands and over 1,000 in number, which ownership represented approximately 50% of the total acreage of the proposed and planned project, and said plaintiffs had also caused to be accomplished necessary and advantageous changes in the Washington State Irrigation [48] District Laws through their work in the Washington State Legislature in 1911 and 1913, and had directly helped to secure appropriations from the State of Washington and from the U. S. Government for geological surveys in the State of Washington, which included the first topographical maps covering the Priest Rapids area.

#### IV.

That plaintiffs had made or caused to be made engineering investigations of every phase of the proposed Priest Rapids project including power and irrigation development and scientific crop raising and production, and had organized plans and studies for the use of mechanized equipment in all phases of the project when necessary and applicable, and said plaintiffs had likewise acquired and secured control of a large acreage of undeveloped land known as the Priest Rapids Highlands and had worked out a transportation system, including the proposed and ultimate construction of the Chicago, Milwaukee, St. Paul & Pacific Railroad to

said valley, and the extension of telephone and telegraph facilities to said area; and said plaintiffs had financially interested various friends, and interests for the purpose of being able to colonize said land and property and develop said land and project, and pursuant thereto plaintiffs had undertaken said work and assumed and paid a great deal of the proposed costs of the development.

## V.

That prior to the time of the formation of the joint venture hereinafter alleged, the General Electric Company had organized the Electric Bond & Share Company in 1905 for the following purposes:

- (1) To realize on various securities acquired in the sale of its equipment.
- (2) To obtain proprietary stakes in growing and promising young industry.
- (3) To advance the sales of its equipment.

That the said General Electric had grown to be and was the world's [49] largest manufacturer of electrical equipment, and was represented by it in conversations with plaintiffs by one Charles A. Coffin, then chairman of the board, and by one Sidney Z. Mitchell, representative and agent of the General Electric Company, and likewise at the time of the organization of the joint venture, the President of the Electric Bond & Share Company, and likewise chairman of the board of the American Power & Light Company, which owned, controlled

and used the said Washington Irrigation & Development Company as a dummy agent and instrumentality of the defendant corporations named herein and particularly of the General Electric Company and American Power & Light Company; that all of the defendant corporations herein were organized and employed for the purpose of promotion of the interests of the defendant, General Electric Company and were directly under the control of the General Electric Company, and said corporations organized and controlled at all times herein the Washington Irrigation & Development Company as a dummy and instrumentality of said defendant corporations and particularly the defendant General Electric Company.

## VI.

That prior to the entry of the parties, defendants and plaintiffs, into the joint venture, said defendant, General Electric, had made certain investments in the Priest Rapids power site for the purpose of developing a hydro-electric power project and had acquired certain acreage on the west bank of the Columbia River upstream from the foot of Priest Rapids, which said defendant, General Electric, held, owned and controlled through its dummy, Washington Irrigation & Development Company; that following said first investment other power site lands were acquired by defendant, General Electric, on the opposite side of the river or the east bank of the Columbia, and said land had been acquired from the Robert E. Strahorn in-

terests, which held said land under the name of Columbia River Reclamation Company of Spokane, Washington, [50] a Washington corporation.

## VII.

That about the year 1910, the Congress of the United States had enacted certain water power legislation which was restrictive of defendant corporations' interests, which proposed to finance and construct hydro-electric dams on navigable streams, and there was a general adverse attitude of the public and Congress toward the defendant corporations' proposals and expansion and there was concerted and general opposition to the plans of said defendant corporations in hydro-electric development and otherwise, and such attitude made it impossible for said defendant corporations to proceed at said time with the proposed plans then had and held by said corporations to develop hydro-electric power by construction of a dam at Priest Rapids.

## VIII.

That thereafter and shortly prior to the formation of the joint venture hereinafter alleged, the defendant corporations, General Electric Company and Electric Bond & Share, through their agents and representatives and through Mr. Sidney Z. Mitchell and Mr. Charles Coffin, entered into discussion with said plaintiffs, which discussions were held in Washington State and in New York by said defendants and their representatives and Messrs. Mitchell and Coffin and said plaintiffs; that the de-

fendants advised plaintiffs that there would be interference with their proposed projects of the defendants at Priest Rapids if plaintiffs proceeded with their plans, and that likewise the plans of plaintiffs at said time for power and irrigation did not require Federal approval, whereas proposals of defendants did require such approval; that a combination of defendants and plaintiffs could in all probability complete full power development and irrigation at Priest Rapids and that the plaintiffs, with their proposals and in their position with their plans and interests could [51] probably obtain some change in the objectionable Water Power Laws which adversely and directly affected the defendants, particularly the General Electric Company.

## IX.

That in the spring of 1913 with knowledge of the acts, endeavors and accomplishments of said plaintiffs, the said defendants, General Electric Company, Electric Bond & Share and American Power & Light, and the said Dam Brothers, entered into a joint venture between all of the parties for the purpose of a complete power and irrigation development of the area heretofore described; that said joint venture was entered into in April, 1913, at 71 Broadway, New York City, New York, and said agreement between the defendant corporations and plaintiffs herein was oral and was never reduced to writing.

## X.

That at the time of the entry of the parties into the joint venture set out in Paragraph IX of this complaint, it was agreed between defendants and plaintiffs that said plaintiffs would:

- (a) Withhold plaintiffs' plans for the development which they proposed at Priest Rapids and join defendant, General Electric Company, and the other defendants, in a joint substitute plan for the single and full development of the Priest Rapids area for the benefit of defendants and plaintiffs.
- (b) Help secure additional power site and industrial lands which would be turned over to defendants for the purpose of constructing the dam which would be constructed by defendants upon the passage of necessary Federal legislation.
- (c) Make available to the defendants all of plaintiffs' records, investigations, field work and knowledge as it related to resources, minerals, materials, power, irrigation, etc.
- (d) Jointly acquire with the defendants the 55,000 acres [52] controlled by plaintiffs which was part of plaintiffs' original project and would jointly work with and continue control of private lands and private landowners, and protect thereby the plaintiffs' plans for irrigation and defendants' plans for power development and industrial expansion.
- (e) Employ plaintiffs' resources, connections and proposals to obtain favorable water power legislation which would permit the construction by the

defendants of a dam at Priest Rapids, and would help in the education and promotion of the project with county, state and federal officials so that the complete joint development of the project as a power generating project and irrigation development plan could be accomplished, and so that a wide, diversified manufacturing and farming community could be developed.

## XI.

That at the time of the entry of the parties hereto into the joint venture, it was agreed by the defendants with plaintiffs that:

- (a) The plaintiffs would receive Five Hundred Thousand Dollars (\$500,000) of the common stock of Priest Rapids Power Company which defendants would incorporate for a sum of approximately \$40,000,000 upon the passage of favorable power legislation.
- (b) That plaintiffs were to own a large percentage of a land holding syndicate to be formed immediately and which was to purchase the 55,000 acres of land controlled by said plaintiffs and said plaintiffs were to jointly control said land with the defendant corporations and their various officials.
- (c) That plaintiffs were to receive a 10% interest in a Townsite Terminal Company which was to include industrial, business, residential and terminal property operations and which was to be incorporated upon the formation of the power company.

(d) That plaintiffs were to receive 10% interest in all the other various syndicates and companies to be organized for the [53] purpose of acquiring minerals, resources, etc., in connection with the Priest Rapids development.

(e) That defendants would furnish funds for the activities and expenses during the preconstruction period, and during the period of the legislative work, and the defendants likewise promised that their activities in behalf of said plaintiffs would be commenced and pursued following favorable legislation by the Congress of the United States.

## XII.

That the plaintiffs have duly performed each and every obligation and term of the joint venture on their part to be performed and said plaintiffs did co-operate and perform along with the defendants all of the incidental and substantial acts required to be done and performed in securing for all of the parties herein the proposed objectives of the co-adventure; that pursuant thereto there was formed the land syndicate with agreement as to division of ownership between defendants and plaintiffs and agreement as to the unit voting of the respective interests and with full agreement as to the ultimate management of the lands following favorable water power legislation; that likewise certain ownership of lands was combined and acquired by the co-adventurers to preclude interference in the plans of the co-adventurers by other interested parties or individuals and plaintiffs also made available to the

defendants knowledge of the assets of valuable tufa deposits which were to be acquired and employed and used in securing the ultimate objectives of the co-adventurers.

### XIII.

That likewise in the performance of the operations undertaken by plaintiffs, they did then undertake to aid, assist and secure certain legislation in the Federal Congress for a dam at Priest Rapids and finally did contribute directly and materially to the passage of such legislation when the Second Session of the [54] 66th Congress passed the Water Power Bill in March, 1920, despite delay in the procurement of said legislation due to conflicting views on the types of legislation which existed between plaintiffs and defendants.

### XIV.

That thereafter application for permit for the dam at Priest Rapids was filed by the General Electric and defendant Electric Bond & Share in the name of said defendants' agent and dummy, the said Washington Irrigation & Development Company.

### XV.

That on March 3, 1921, the Federal Power Commission issued a permit for the dam at Priest Rapids as Power Project No. 3 and the said defendants, Electric Bond & Share, and General Electric Company, undertook diamond drilling of the dam foundation and proceeded with engineering work and plans in the engineering offices of the

respective defendants in New York City; that the field work and engineering plans for said dam were completed in June, 1922, and defendants and Sidney Z. Mitchell strongly requested that the plaintiffs proceed and complete the irrigation engineering for the Priest Rapids Highlands project for the purpose of providing irrigation for approximately 135,000 acres of land, which included the holdings of plaintiffs and defendants in the land-holding syndicate company which had been formed by said parties; that plaintiffs upon the assurance of the defendants and of Sidney Z. Mitchell expended large sums of money for the irrigation work and assisted materially in raising funds, and paying funds of plaintiffs to acquire such land as was necessary and to perform such engineering as was required and suggested by the defendants and Sidney Z. Mitchell.

## XVI.

That on March 25, 1925, the Federal Power Commission issued a license for the dam at Priest Rapids to be constructed by the defendants; that at said time, however, defendants and all of them, [55] had embarked upon an expansion of their electrical industries and stock promoting scheme, and there was vast and immediate increase in manufacturing electrical appliances, and in construction of utility properties, and in the acquiring of utility properties, and in their use in activities of industry and agriculture, and the assets of the defendants, and each of them, grew to enormous proportions, and such expansion was substantially a result of the

efforts expended by plaintiffs herein pursuant to the agreement of joint venture heretofore made and described in this complaint; that the defendants, however, did not then proceed with the construction of the dam at Priest Rapids, and prior to the time that construction could begin there had occurred a general depression in the United States, and a failure therefor of the prosecution of a vigorous government policy in the construction of large hydroelectric projects, which period of time was followed by World War II with restrictions on the development and use of labor, materials, etc., which likewise materially impeded the progress in reaching the objectives of the co-adventurers; that during and following such period and thereafter, the defendants, represented to said plaintiffs that they were continuing with said co-adventure.

## XVII.

That, however, the defendants were engaging in activities which were adverse to the interests of the co-adventure and said defendants were not performing at said time in accord with the obligations assumed by said defendants at the time of the making of the agreement of co-adventure; that such facts were not known by plaintiffs at said time, nor could they be so known; that none of defendants did state, nor did they represent at any time to said plaintiffs, that they were in anywise abandoning the prosecution of the co-adventure; that the plaintiffs herein did not and could not know that there was any complete or final repudiation or abandonment

of the agreement of co-adventure until some time in the [56] early part of the year 1951 when plaintiffs learned that defendants, and all of them, did not intend to proceed with the development of the Priest Rapids project or with the prosecution of any of the obligations assumed by them; that therefore a written demand was made by plaintiffs on June 14, 1951, for full settlement to be made by defendants with plaintiffs in accord with the agreement of co-adventure, the fulfillment of the obligations of which had occupied the efforts and acts of the plaintiffs from 1913 until the year 1951; that therefore plaintiffs believe and allege that the purpose of said joint venture is now incapable of performance because the said defendants, and each of them, have breached the terms thereof and have repudiated the same to the damage of the plaintiffs herein.

## XVIII.

That as a direct and proximate result of defendants' breach of the joint-venture agreement, the plaintiffs have suffered loss and damage as follows:

1.	Priest Rapids Power Company, common stock .....	\$ 500,000.00
2.	10% interest, Townsite Terminal Co., common stock.....	250,000.00
3.	10% interest, Limestone Company, construction supply-chemical works user .....	100,000.00
4.	30% interest, Tufa Natural Ce- ment Co., common stock.....	50,000.00

5. Hydro-Chemical Operations .....	90,000.00
6. Expectant contemplated profits and development of materials, electrical furnace, chemicals, industries and wood products .....	300,000.00
7. Land—Syndicate, 50,000 acres (3 rural townsites, completely engineered project), 30% of total profit	900,000.00
8. Engineering 135,000-acre project, irrigation, power, etc.....	250,000.00
9. Private owned lands, Highlands..	750,000.00
10. Offices, laboratory, ranches, equipment, livestock, homes, autos.....	160,000.00
11. Mines, mineral lands, research engineering, professional records, maps and reports.....	200,000.00
	<hr/>
	\$3,550,000.00

and the plaintiffs have suffered further damage as a result of defendants' [57] breach as heretofore alleged to finances and credit, loss of business and engineering opportunities, activities and operations, loss of value of professional and business records, use of the knowledge and time in a sum total of \$5,000,000.00, or in a total in all of \$8,550,000.00.

For a second cause of action, plaintiffs complain and allege as follows:

## I.

Plaintiffs reallege Paragraphs I, II, III, IV, V, VI, VII, VIII, IX, X, XI, XII, XIII, XIV, XV, XVI, and XVII of their first cause of action as though fully set out herein.

## II.

That defendants and all of them did use and employ the efforts of plaintiffs during the co-adventure between said parties and the results obtained by said plaintiffs in effecting favorable legislation and otherwise heretofore pleaded in plaintiffs' first cause of action for the purpose of making and obtaining for the defendants, and each of them, huge profits through the expansion of their facilities and said defendants did make use of, for their own benefit, the various accomplishments of the plaintiffs in procuring for the said defendants, and each of them, to the exclusion of the plaintiffs, great and immense profits in their enterprises, the value of which cannot now be determined by these plaintiffs.

Wherefore, plaintiffs pray for:

1. Judgment herein against the defendants, and each of them, on plaintiffs' first cause of action for the sum of \$8,550,000.00, together with their costs and disbursements herein.
2. That an accounting be taken of all the affairs alleged herein in plaintiffs' second cause of action and that plaintiffs be given damages in an amount

deemed equitable by the court in [58] respect to the contributions made by said plaintiffs herein.

3. For such other and further relief as to the Court may seem just and equitable.

/s/ R. MAX ETTER,

/s/ ROBERT L. BELL,

/s/ HARVE H. PHIPPS,

Attorneys for Plaintiffs.

Receipt of copy acknowledged.

[Endorsed]: Filed November 15, 1952. [59]

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[Title of District Court and Cause.]

MOTION TO DISMISS  
AMENDED COMPLAINT

Defendant American Power & Light Company moves the court as follows with respect to plaintiffs' amended complaint herein:

I.

To dismiss the action because the complaint fails to state a claim against defendant upon which relief can be granted.

II.

To dismiss the action or in lieu thereof to quash the return of service of summons on the ground:

(a) That the defendant is a corporation organized under the laws of the State of Maine and was not and is not subject to service of process in the Eastern District of Washington nor in the State of Washington; and,

(b) That the defendant has not been properly served with process in this action, all of which more clearly appears in the affidavit of Howard L. Aller, annexed to this defendant's original motion to dismiss and on file herein.

### III.

To dismiss the action on the ground that it is in the wrong [60] district because:

(a) The jurisdiction of this court is invoked solely on the ground of diversity of citizenship and neither all the plaintiffs nor all the defendants reside in the Eastern District of Washington; and,

(b) All the defendants are indispensable parties and Electric Bond and Share Company is also an indispensable party and neither this defendant nor Electric Bond and Share Company is subject to service of process in the Eastern District of Washington, nor in the State of Washington, all of which more clearly appears in the affidavit of Howard L. Aller, attached as Exhibit A to this defendant's original motion to dismiss and the motion to dismiss of defendant Electric Bond and Share Company, both of which are on file herein to which reference is hereby made. All defendants are subject to suit in the State of New York.

/s/ ALAN G. PAINE,

/s/ ALAN P. O'KELLY,

Attorneys for Defendant American Power & Light  
Company.

[Endorsed]: Filed December 3, 1952.

[Title of District Court and Cause.]

## COURT'S ORAL RULING ON MOTIONS TO DISMISS

Be It Remembered that the above-entitled cause came on for hearing at Spokane, Washington, on November 17, 1952, for hearing on motions to dismiss, before the Honorable Sam M. Driver, Judge of the above-entitled Court; the plaintiffs being represented by Harve H. Phipps and R. Max Etter; the defendants being represented by Philip S. Brooke and Alan G. Paine, all of Spokane, Washington; and the following is the Court's oral ruling on the motions:

The Court: I think the Court is sufficiently [61] in doubt so that all of these people should be kept in. I don't know what would happen in the final outcome of the lawsuit, but I don't want to let out somebody and then have it develop that the wrong one has been let out. Perhaps that might be a rather practical way to view it, but, while I am very much in doubt as to liability here, I think that for the purposes of these motions, I will deny the motions and leave all these companies in. Then we will see what happens.

Mr. Paine: Do I understand from that that your Honor feels that the mere mailing of an uncertified copy of the complaint by Mr. Phipps to Electric Bond and Share—

The Court: Well, now, let's see, which one do you have in mind, Mr. Paine?

Mr. Paine: Electric Bond and Share. I think there is no question that Electric Bond and Share—

The Court: What do you say about that?

Mr. Etter: They may have been out, I don't know about proper service.

The Court: I think that that is an improper service, yes. If you want to put it down to that one, I think that that is an improper service and the service will be ordered quashed on Electric Bond and Share.

Now, do you have any other particular one?

Mr. Paine: Well, I still feel very strongly that the [62] service should be quashed on American Power and Light.

The Court: What was the service on American Power and Light?

Mr. Etter: Washington Irrigation and Development Company.

Mr. Paine: They served the agent of the Washington Irrigation and Development Company.

Mr. Etter: Served the company itself. That is 100 per cent owned by American Power and Light.

The Court: Well, I will hold that that is good, but your—

Mr. Paine: Electric Bond and Share.

The Court: Your motion is granted on that.

Court will adjourn then until tomorrow morning at 10:00 o'clock. [63]

Reporter's Certificate

United States of America,  
Eastern District of Washington—ss.

I, Donald B. Oden, do hereby certify:

That at all times herein mentioned I was the duly appointed, qualified and acting official court reporter of the United States District Court for the Eastern District of Washington; that as such reporter I reported in machine shorthand and transcribed the foregoing proceedings before the Honorable Sam M. Driver, United States District Judge, held at Spokane, Washington, on November 17, 1952; that the within and foregoing is a full, accurate and complete transcript of the Court's ruling on the motions on this date.

Dated this 23rd day of February, 1957.

/s/ DONALD B. ODEN,  
Official Court Reporter.

[Endorsed]: Filed February 26, 1957. [64]

United States District Court for the Eastern  
District of Washington, Northern Division

No. 1036

MILTON E. DAM and EVERETT S. DAM, Co-  
partners Doing Business Under the Firm Name  
and Style of DAM BROTHERS,Plaintiffs,  
vs.GENERAL ELECTRIC COMPANY, a Foreign  
Corporation; AMERICAN POWER & LIGHT  
COMPANY, a Foreign Corporation, and  
ELECTRIC BOND & SHARE COMPANY, a  
Foreign Corporation,

Defendants.

## OPINION OF THE COURT

Driver, Chief Judge.

Defendant American Power and Light Company, hereafter called American, by its motion to quash the return of service of process and to dismiss the action, questions the sufficiency of the service and its own amenability to service, within the State of Washington. The action was commenced by the filing of the complaint, on July 16, 1952. The return of service shows that, on the following day, the summons and complaint were served upon American by handing copies thereof to the statutory agent of the Washington Irrigation and Development Company, at Vancouver, Washington.

The pertinent facts are set forth in the amended complaint and in an affidavit of Howard L. Aller, president of American. These documents, as counsel on both sides seem to agree, may be considered by the court in the light of the related information contained in the published reports of the Securities and Exchange Commission and the federal courts dealing with the creation, the corporate structure, and the interrelationship of the three corporations named as defendants in the present action.<sup>1</sup>

So far as it is necessary to consider them here, the allegations of the amended complaint are as follows:

The defendants General Electric Company (referred to herein as General) and Electric Bond and Share Company (hereafter designated Bond and Share) are New York corporations. Defendant American is a Maine corporation, which is doing business in the State of Washington. At all times mentioned (which covers a period from prior to 1913 to July, 1952), General and American have wholly controlled the Washington Irrigation and Development Company, a Washington corporation, and have used it as a "dummy" and instrumentality, so that they could perform their respective

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<sup>1</sup>In re Electric Bond & Share Co., et al., 11 Securities and Exchange Commission decisions and reports, 1146; American Power and Light Co. v. Securities and Exchange Commission, 1 Cir., 141 F. 2d 606; American Power and Light Co. v. Securities and Exchange Commission, 329 U. S. 90.

businesses through and by it. Prior to and at the time of the commencement of the action, the Washington corporation was owned by American and was being used by it in the same manner and for a like purpose. In April, 1913, all three defendants and the plaintiffs, in the City of New York, entered into an oral joint venture agreement for the construction of a dam and hydroelectric power plant, at the Priest Rapids site, on the Columbia River, in the State of Washington, and for the irrigation of a large area of adjacent, arid land. Prior to the making of the agreement, plaintiffs had done considerable preliminary development work. General had "made certain investments in the Priest Rapids power site" and had acquired certain nearby land which it "held, owned and controlled through its dummy, Washington Irrigation and Development Company." After the joint venture agreement had been made, General and Bond and Share, in the name of their "agent and dummy," Washington Irrigation and Development Company, applied for a permit for construction of the dam at Priest Rapids and the Federal Power Commission issued a permit on March 3, 1921. Bond and Share and General then "undertook diamond drilling of the dam foundation" and proceeded with engineering work and plans in the engineering offices of the respective defendants in New York City. The field work and engineering plans [91] for the dam were completed in June, 1922. On March 25, 1925, the Federal Power Commission issued a license for the dam. Construction was long delayed, however, by

various enumerated conditions and events, and, ultimately, defendants abandoned and breached the joint venture agreement, to plaintiffs' damage in a very large sum.

Summarized briefly, the factual recitals in the affidavit of Mr. Aller, the president of American, are as follows:

American was created under the laws of the State of Maine, September 20, 1909. Throughout its entire corporate existence, it has had its principal office in Augusta, Maine. It has also maintained an office in New York City, but has had no other office, and, specifically, has not maintained any place of business in the State of Washington. The corporation has always been a holding company, engaged in the business of acquiring, in New York State and interstate commerce, and holding for investment and realization thereon, the securities of public utility companies operating in various states, including the State of Washington; but it has never conducted any of "its ordinary or regular business" in that state. The Securities and Exchange Commission, acting pursuant to the Public Utility Holding Company Act of 1935, by an order dated August 22, 1942, directed that the existence of American be terminated and the corporation dissolved. The order was affirmed successively by the United States Court of Appeals for the First Circuit and the Supreme Court.<sup>2</sup> Since November 25, 1946, the date

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<sup>2</sup>For case citations, see Footnote 1.

of the Supreme Court decision, American has been in process of dissolution. The corporation owns no property in the State of Washington. It owns all of the outstanding capital stock and debt securities of the Washington Irrigation and Development Company, whose only assets in Washington are some lands, largely uncultivated and idle, and certain securities of the Limestone Company, a Washington corporation, which owns real estate in the State of Idaho. The Washington Irrigation and Development Company transacts no business, except the incidental leasing of minor portions of its real estate. It engages in no business whatsoever on behalf of American, and, at no time, has it transacted or engaged in business as agent or representative of American. Pursuant to an order of the Securities and Exchange Commission, dated June 6, 1952, and an order of the United States District Court for the district of Maine, dated July 17, 1952, American will dispose of all of its interest in the Development Company. The books and records of the two corporations are kept "separate and distinct." American has never qualified as a foreign corporation under the laws of the State of Washington. It has never maintained, appointed, or located any officer or managing or general agent in Washington to conduct its business or receive service of process; and, for several years, it has entered into no commercial transactions whatsoever in that state.

This is a civil action, governed, as to the manner, of service of process, by the Federal Rules of Civil

Procedure. The rules provide that service shall be made upon a foreign corporation by delivering a copy of the summons and of the [93] complaint to an officer, a managing or general agent, or to any other agent, authorized by appointment or by law to receive service of process.<sup>3</sup> The rules further provide, however, that it is sufficient if the summons and complaint are served on a foreign corporation defendant in the manner prescribed by the law of the state in which the service is made for the service of summons on any such defendant in a state Court action.<sup>4</sup> The applicable Washington statute recites that summons shall be served upon a foreign corporation, "doing business within the state" by delivering a copy thereof to any agent, cashier, or secretary thereof.<sup>5</sup>

In the present case, as stated above, American was served by delivery of the summons to the statutory agent of Washing Irrigation and Development Company, a wholly owned subsidiary of American. The service was insufficient to meet the requirements of either the Federal Rules or the State Law, unless we disregard the separate corporate entity of the domestic corporation and regard service upon it as, in legal effect, service upon American.

It is a well established general rule that a foreign corporation, which owns or controls the capital stock

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<sup>3</sup>Fed. Rules Civ. Proc. Rule 4 (d)(3), 28 U.S.C.A.

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<sup>4</sup>Fed. Rules Civ. Proc. Rule 4(d)(7), 28 U.S.C.A.

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<sup>5</sup>RCW 4.28.08(9).

and dictates the policies and directs the affairs of a subsidiary corporation, which is doing business within a state, is not [94] thereby subject to service of process through service upon an agent of the subsidiary in that state. A leading case is *Cannon Manufacturing Company v. Cudahy Packing Company*, 267 U. S. 333.<sup>6</sup> There, as in the present action, a foreign corporation was served with process by service upon the agent of its subsidiary corporation, doing business within the state of service. Cudahy, a Maine Corporation, used the wholly owned and completely dominated subsidiary corporation, Cudahy of Alabama, to market the parent company's products in North Carolina. In its opinion, the Court observed that the device of doing business in North Carolina through the subsidiary was, doubtless, adopted solely to secure some advantage to the parent; but it pointed out that the distinct corporate entity of the subsidiary was in all respects observed. The Court concluded that the corporate separation, although "perhaps merely formal, was real" and not "pure fiction" and held that the defendant parent corporation was not subject to service of process in North Carolina.

*Cannon v. Cudahy*, *supra*, has never been overruled. It was relied upon and followed by the Ninth Circuit Court of Appeals in the recent case of *Gravely Motor Plow & Cultivator Co. v. H. V. Carter Co.*, 193 F. 2d 158. The Supreme Court of

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<sup>6</sup>For other cases in which the rule has been applied, see annotation, 18 A.L.R. 2d, 187, 194.

Washington also applied the general rule, stated above, in *State v. Northwest Magnesite Co.*, 28 Wn. (2d) 1, 40, and, in so doing, cited *Cannon v. Cudahy*, as a supporting authority.<sup>7</sup> [95] The author of the American Law reports annotation<sup>8</sup> states, by way of exception to the general rule, that, if there are facts in addition to stock ownership sufficient to convince the Court that the form of corporate separation is a mere fiction, and the subsidiary corporation is only an adjunct or instrumentality of the foreign parent corporation, then the parent will be regarded as doing business in the state and subject to its jurisdiction for the service of process. The statement is deceptively simple. The difficulty arises when the test, whether the subsidiary is a mere adjunct or instrumentality of the parent, is applied to a particular set of facts. The cases in which the corporate separation has been disregarded have taken a wide range. It is difficult to classify them, but they do support the general conclusion that there must be a showing of something more than complete control and direction of the subsidiary by the parent. Absolute domination, through capital stock ownership and its incidents, is not alone sufficient, even though the subsidiary is the instrumentality employed by the parent for the transaction of the latter's busi-

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<sup>7</sup>Another case factually similar to the case at bar, in which *Cannon v. Cudahy* was followed, is *Lane v. Maple Leaf Milling Co.*, 87 F. Supp. 741.

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*v. Maple Leaf Milling Co.*, 87 F. Supp. 741.

ness within the forum state. In this connection, attention is again directed to *Cannon v. Cudahy*, *supra*. There, the parent, for its own advantage, used the subsidiary corporation as a medium for the Transaction of business in North Carolina, and the completeness of the subservience of the subsidiary appears in the following quotation from the opinion, at page 335: [96]

Through ownership of the entire capital stock and otherwise, the defendant [the parent corporation] dominates the Alabama Corporation [the subsidiary], immediately and completely; and exerts its control both commercially and financially in substantially the same way, and mainly through the same individuals, as it does over those selling branches or departments of its business not separately incorporated which are established to market the Cudahy products in other states.

An exception to the general rule is recognized where a plaintiff seeks to hold a parent corporation liable for an act or omission of its subsidiary corporation, or to enforce against a subsidiary a liability of the parent, and the primary concern is with the enforcement of substantive rights. A number of cases, apparently regarded by the Court as within the exception, are cited and expressly distinguished in *Cannon v. Cudahy*, *supra*, page 337.

Another exception is recognized where a corporate subsidiary is used as an instrumentality or adjunct of the parent corporation for the accomplishment of

some illegal or fraudulent or dishonest purpose.<sup>9</sup> Commenting on the exceptions to the general rule in *State v. Northwest Magnesite Company*, *supra*, page 42, the Supreme Court of Washington expressed the view that "whether the Courts will disregard the corporate form is ultimately a question of whether there is good faith and honesty in the use of corporate privilege for legitimate ends." In support of the statement, the Court cited [97] *Sommer v. Yakima Motor Coach Co.*, 174 Wash. 638, 26 p. (2d) 92 and *McCurdy v. Spokane Western Power & Traction Co.*, 174 Wash. 470, 24 P. (2d) 1075. In the first of the cited cases (opinion, page 654), the Washington Court said that two corporations "are not to be adjudged as one, in legal effect, unless their property rights and interests are so closely commingled and related as to render it apparent that they are intended to function as one, and to regard them separately would aid the consummation of a fraud or wrong upon others."<sup>10</sup> In the other cited case, the same Court, at page 496 of the opinion, made this observation:

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<sup>9</sup>*Dobson Corp. v. Farbenfabriken Co. of Elberfeld Co.*, 206 F. 125. See also *Hazeltine Corp. v. General Electric Corp.*, 19 F. Supp. 898, 903, and *Industrial Research v. General Motors*, 29 F. 2d 623, 627. The case last cited is an example of an action against a parent corporation for patent infringement by manufacture or sale of the patented device through controlled subsidiary corporations.

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<sup>10</sup>See also *First National Bank v. Walton*, 146 Wash., 367; *Briggs & Co. v. Harper Clay Products Co.*, 150 Wash., 235.

In adjudicating two corporations to be, in legal effect, one, it must appear that the one so dominates and controls the other as to make the other a mere tool or instrument of the one, so that justice requires the dominant corporation to be held liable for the results, and further, that there shall be such a commingling of their funds and property interests, and their affairs so intimately related in management, that to consider them other than as one would work a fraud upon third persons.

It does not appear that American has had any contacts in the State of Washington, except through its subsidiary corporations.<sup>11</sup> If it is subject to service of process in the instant case, it must be because of its connections with Washington Irrigation and Development Company. Plaintiffs base their claim for relief upon a joint venture agreement, made with American directly, in the State of New York, after the [98] Washington Irrigation Company had been created. They do not seek to hold American liable for any acts or omissions of the subsidiary. There is no contention that the organization of the Washington Corporation, or its use by American, was illegal, dishonest, or fraudulent. The amended complaint alleges that the subsidiary was a "dummy" and instrumentality, employed by American and the other defendants for the transaction of

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<sup>11</sup>American owns all of the capital stock of another domestic corporation, The Washington Water Power Company, which is not involved in the present action.

their business within the State of Washington, it is true; but such general allegations go no further than to show complete domination and control of the subsidiary by the parent, through stock ownership and otherwise, such as existed in *Cannon v. Cudahy*. There is no showing of additional facts sufficient to take the present case out of the operation of the general rule. On the other hand, Mr. Aller's affidavit states that the business conducted by the subsidiary is entirely different and separate from that of American, that the subsidiary has never transacted or engaged in business as the agent or representative of American, and that the books and records of the two companies are kept separate and distinct. It must be concluded, therefore, that American was not served with process effectively by the delivery of a copy of the summons to the statutory agent of its subsidiary corporation.

The motion under consideration, however, raises a broader issue than the procedural sufficiency of the service of process upon American. Even if service had been made in the manner prescribed by the civil rules and the Washington Statute, jurisdiction would not be vested in this Court, unless the requirements of due process of the United States Constitution [99] have been satisfied.<sup>12</sup> Such re-

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<sup>12</sup>Peoples' Tobacco Co. v. American Tobacco Co., 246 U. S. 79; Chipman, Ltd., v. Jeffery Co., 251 U. S. 373; Bomze v. Nardis Sportswear, 165 F. 2d 33, 35; Favell-Utley Realty Co. v. Harbor Plywood Corp., 94 Fed. Supp. 96, 98.

quirements have been discussed by the Supreme Court on many different occasions. The cases differ widely as to their facts, and it has often been said that each case must depend upon its own particular circumstances. But in *People's Tobacco Co. v. American Tobacco Co.*, 246 U. S. 79, 87, the Court formulated a general principle to the effect that a foreign corporation must be doing business in a state to be subject to service of process there, and "the business must be of such a nature and character as to warrant the inference that the corporation has subjected itself to the local jurisdiction, and is, by its duly authorized officers or agents, present within the state or district, where service is attempted." Although the cited case and others of like purport have not been overruled, the modern trend of judicial thought appears to be toward a more liberal interpretation of what constitutes doing business by a foreign corporation. In one of the later cases, *International Shoe Co. v. Washington*, 326 U. S. 310, the Supreme Court, citing many of its prior decisions dealing with due process, made the following observations (pages 316 to 319): A corporation has a fictional personality and, therefore, can be present in a state only through the activities of its representatives or agents. The demands of due process may be met by such contacts or activities of the corporation, through its agents, "with the state of the forum as to make it reasonable, in the context of our [100] Federal System of Government, to require the corporation to defend the particular suit which is brought there." Presence of a corporation in the

state, in this vicarious sense, has never been doubted when its activities have "not only been continuous and systematic, but also give rise to the liabilities sued on." On the other hand, "the casual presence of the corporate agent, or even his conduct of single or isolated items of activities in a state, in the corporation's behalf, are not enough to subject it to suit on causes of action unconnected with such activities." The test is essentially qualitative rather than quantitative. Whether due process requirements have been met depends upon the quality and nature of the activity "in relation to the fair and orderly administration of the laws which it was the purpose of the due process clause to insure." It is not in accord with due process to render in a state a judgment in personam against a corporate defendant "with which the state has no contacts, ties, or relations."

It fairly appears, without more extensive review of the authorities, that the minimum requirements necessary to satisfy due process, where the action is not based upon any activities of the foreign corporation within the forum state, are that there must be some substantial business activity carried on by such corporation within the state, and the activity must amount to more than casual, isolated, or disconnected transactions, or the mere presence in the state of a passive agent or agency of the corporation.

As has been pointed out, plaintiff's action is based upon a breach of a joint venture agreement, not

upon any [101] business activity of American within the State of Washington. The amended complaint states the conclusions that American "is doing business in the State of Washington" and that it has used its subsidiary, Washington Irrigation and Development Company as a "dummy" and instrumentality for the transaction of its business; but there is no specific allegation that American has performed any business act, or carried on any business activity in the state, either directly or through a subsidiary corporation. The only showing in the amended complaint of any particular business activity carried on through the Washington Irrigation and Development Company consists of allegations to the effect that General acquired lands near Priest Rapids, which it held, owned, and controlled through the Washington Company as its dummy, and that General and Bond and Share applied for a permit to build a dam at Priest Rapids through the Washington Corporation, as their agent and dummy. On the other hand, it appears from the affidavit of American's president that, since November 25, 1946, American has been in the process of dissolution and has entered into no commercial transactions in the State of Washington for the last several years. It seems clear that minimum due process requirements have not been met.

The motion of defendant American is granted.

[Endorsed]: Filed April 7, 1953. [102]

[Title of District Court and Cause.]

NOTICE OF HEARING ON MOTION FOR  
LEAVE TO SERVE AND FILE SECOND  
AMENDED COMPLAINT

To the Above-Named Defendants, and to Hamblen,  
Gilbert & Brooke and Paine, Lowe & Coffin,  
Their Attorneys:

You, and each and all of you will please take notice that the plaintiffs will present to the court in the above-entitled action and bring on for hearing and determination by the court the attached Motion for Leave to Serve and File Second Amended Complaint, together with the affidavit of Harve H. Phipps and plaintiffs' proposed Second Amended Complaint thereto attached, on the 5th day of November, 1953, at the hour of 10:00 o'clock a.m. of that day, or as soon thereafter as counsel can be heard, at the courtroom of the above-entitled court, in the city and county of Spokane, State of Washington.

Dated this 30th day of October, 1953.

/s/ R. MAX ETTER,

/s/ ROBERT L. BELL,

PHIPPS & PHIPPS,

Attorneys for Plaintiffs.

Service of copy acknowledged.

[Endorsed]: Filed October 31, 1953. [103]

[Title of District Court and Cause.]

**ORDER ON MOTION FOR LEAVE TO SERVE  
AND FILE SECOND AMENDED COM-  
PLAINT**

This cause came regularly on for hearing before the undersigned Judge of the above-entitled court on this 5th day of November, 1953, on the plaintiffs' Motion for Leave to Serve and File Their Second Amended Complaint herein, the plaintiffs appearing by and through their attorney, Harve H. Phipps, and the defendant, General Electric Company, a corporation, appearing by its attorneys Hamblen, Gilbert & Brooke, Phillip S. Brooke appearing, and said motion, with plaintiffs' said Proposed Second Amended Complaint having been presented to the court, and the same was duly argued and considered by the court, and the court being duly advised.

It Is Ordered that the plaintiffs be and they are hereby granted leave to serve and file herein, and to amend their complaint as in said Amended Complaint set forth, and that said Second Amended Complaint do stand and be considered by the court as the plaintiffs' complaint herein.

It Is Further Ordered that the service of said Second Amended Complaint herein on the defendants with the said Motion for leave to serve and file herein their said Second Amended Complaint, do stand as service of said Second Amended Complaint, and,

It Is Further Ordered that the defendants, or any or [104] all of them, do have to and including twenty days from the date of this Order, within which to answer, respond to or move against said Second Amended Complaint.

Dated and done at Spokane, Washington, this 5th day of November, 1953.

/s/ SAM M. DRIVER,  
Judge of United States  
District Court.

Presented by:

PHIPPS & PHIPPS,  
Attorneys for Plaintiffs.

Receipt of copy acknowledged.

[Endorsed]: Filed November 5, 1953. [105]

In the District Court of the United States for the  
Eastern District of Washington, Northern Di-  
vision

No. 1036—Civil

MILTON E. DAM and EVERETT S. DAM, Co-  
Partners Doing Business Under the Firm Name  
and Style of DAM BROTHERS,

Plaintiffs,

vs.

GENERAL ELECTRIC COMPANY, a Foreign  
Corporation; AMERICAN POWER & LIGHT  
COMPANY, a Foreign Corporation; and,  
ELECTRIC BOND & SHARE COMPANY,  
a Foreign Corporation,

Defendants.

### SECOND AMENDED COMPLAINT<sup>1</sup>

Come now the plaintiffs and for their First Cause  
of Action against the defendants complain and  
allege:

#### I.

The plaintiffs are now and at all times herein  
mentioned have been citizens and residents of the  
State of Washington.

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<sup>1</sup>[In conformity with the Court's Order of Sept.  
14, 1955 (See pages 100-101 of this printed record),  
certain portions of this Second Amended Complaint  
are stricken by drawing a line through same without  
rendering it illegible and by interlineation.]

## II.

The Court has jurisdiction of the above-entitled action for the reason that there is a diversity of citizenship of the parties to this action, the plaintiffs being citizens and residents of the State of Washington, and each and all of the defendants being corporations organized and existing under laws foreign to the State of Washington, and the matters in controversy exceed the sum of three thousand dollars (\$3,000.00) exclusive of interest and costs.

## III.

The defendant, General Electric Company, as a foreign corporation, has complied with the laws of the State of Washington relating to foreign corporations, and is and has been duly authorized and licensed to transact business in the State of Washington, and has paid its license fees to date. [1\*]

## IV.

The defendant, General Electric Company, was incorporated and chartered under the laws of the State of New York on or about April 15th, 1892, with its home office and principal place of business in the City of Schenectady, County of Schenectady, State of New York; that the principal objects and purposes for which said General Electric Company was incorporated, chartered and organized were for the manufacture, development, improvement, production and sale of electrical equipment, appliances, motors, turbines for use in the production of elec-

\*Page numbering appearing at foot of page of original Certified Transcript of Record.

trical power and current, wires and cables to be utilized in the transmission of electrical current, and generally to engage in all phases of the business of manufacturing and producing articles and things to be used and useful in the utilization of electrical power and energy and/or other types of power, such as water, steam, gasoline and kindred powers, the said corporation, General Electric Company, being what is commonly known and designated a "manufacturing company."

## V.

On or about the 27th day of February, 1905, the defendant, General Electric Company, acting by and through its duly qualified and authorized directors and officers, caused to be incorporated under the laws of the State of New York the defendant, Electric Bond & Share Company, for the apparent and ostensible object and purpose, on the part of the said General Electric Company (1) to realize as fully as possible upon various utility securities which it had acquired in the process of selling and disposing of its manufactured equipment; (2) to obtain for itself, the said General Electric Company, a direct proprietary stake or interest in a promising young industry, that is to say the production and development of electrical and other power, with which industry it was then closely related and affiliated, and; (3) to utilize the position it would acquire as a proprietary factor in the utility [2] industry to capitalize and advance the sales of equipment and appliances manufactured, developed and

improved, or to be manufactured, developed or improved by said General Electric Company, and as these plaintiffs are informed and believe and therefore allege the General Electric Company originally invested in and turned over to said Electric Bond & Share Company the sum of approximately one million three hundred thousand dollars (\$1,300,-000.00) in cash, and assigned, transferred and set over to said Electric Bond & Share Company miscellaneous securities it then owned having a par value of approximately four million, two hundred fifty-eight thousand, one hundred fifty dollars (\$4,258,150.00), in return for which the said Electric Bond & Share Company issued and delivered to said General Electric Company all of its authorized and outstanding capital stock of said Electric Bond & Share Company, consisting of two million dollars (\$2,000,000.00) par value of its common stock and two million dollars (\$2,000,000.00) par value of its preferred stock, and thereby the General Electric Company became the company holding all of the issued and outstanding common and preferred stock of said Electric Bond & Share Company, and was and became what is commonly known and described variously as the "holding company," the "parent company," or the "dominant company," and by and through such stock ownership, and the voting rights and powers reposed in it by reason of such stock ownership, the said General Electric Company in all things dominated and controlled the management, activities, acts and actions of the defendant, Electric Bond & Share Company, and by such domi-

nation and control the defendant, General Electric Company, used the purported corporate entity of the defendant, Electric Bond & Share Company for its own uses and purposes , and there was thereby created a confusion of corporate entities so as to mislead and deceive third persons dealing with the said defendant, Electric Bond & Share Company, and the purported corporate entity of said Electric Bond & Share [3] Company was in truth and in fact a fiction, and the fiction of such purported separate legal entity of the defendant, Electric Bond & Share Company, was used by the defendant, General Electric Company, as a means in perpetrating an ostensible fraud and deception upon persons dealing with the said Electric Bond & Share Company, a purported separate legal entity, incorporated, organized and existing for the declared objects and purposes, among others, of buying, selling, handling and dealing in bonds and other securities, principally of utility companies, and was in truth and in fact a mere tool or business conduit of the defendant, General Electric Company, through which the said defendant, General Electric Company, utilized and employed it as a means of perpetrating a monopoly not only for the sale and distribution of its manufactured electrical equipment, appliances and products, but, as hereinafter set out, to monopolize the creation, production and manufacturing of electrical and other power, and the distribution of the same, and the development and use of water and water power for irrigation and other purposes, and the procuring of sites, lands and min-

eral deposits, building and other materials, useful and to be used in the development of power projects, in all of which ventures the said dominant or parent corporation, General Electric Company, used and utilized the defendant, Electric Bond & Share Company for the purpose of financing and raising funds by the sales of bonds and other securities to the investing public, and as the direct and proximate result of its domination and control of the said said Electric Bond & Share Company, and the financial aid and assistance created for the General Electric Company by the defendant, Electric Bond & Share Company, said General Electric Company was able to and did become the world's largest manufacturer of electrical appliances and equipment, dominating and monopolizing a great or major portion of the field of such industry, and in addition thereto, as hereinafter set out, created and dominated [4] the field of the manufacturing and distribution of electrical energy and power as well as developing water power in the production, creation and manufacturing of such electrical energy and power, all of which was made possible through the fiscal and financial agency of the defendant, Electric Bond & Share Company, so dominated and controlled by the defendant, General Electric Company, as herein set out.

## VI.

Lying in the approximate south-central area of the State of Washington, in the area bounded by the Saddle Mountains on the north and east and by

the Columbia River on the west and south, there is a vast tract of land which, in its original and natural state, is and has been arid or semiarid, the soil of which is of a volcanic ash character, highly porous, and very productive when irrigated, but which, in its natural state, because of its location and the character of its soil is, and has been, unproductive and covered with sagebrush and other vegetation which could grow and thrive without irrigation; along the area herein-above referred to lies the Columbia River on the west and south sides thereof, flowing in a general southerly direction to a point approximately on the border line between the states of Washington and Oregon, and thence westerly to the Pacific Ocean, the said Columbia River entering the State of Washington near the northeast corner thereof, and because if its numerous tributaries to the north of the area herein above referred to, the said river has vast resources of water to be utilized and useful in the development of irrigation for the arid and semiarid lands above referred to, and when harnessed by a dam in said Columbia River, is capable of developing and generating and producing enormous electrical energy to be used and useful in the manufacturing and production of fertilizer, chemical products, pumping water for irrigation purposes, and other innumerable useful purposes. [5]

## VII.

The area or tract above described as lying to the south of the Saddle Mountains and bounded as

above described has along its westerly boundary a portion of the Columbia River which, because of the country surrounding it and the vast amount of water behind it, is, in its natural state a swiftly moving stream, dropping rapidly in elevation, and is known as and called "Priest Rapids," and the project of developing the same for power and irrigation purposes is, and has been generally known as the "Priest Rapids Highlands Project."

## VIII.

The plaintiffs herein are brothers and were raised from early childhood in the territory above described, and, about the turn of the Twentieth Century, about the year 1900, and prior and subsequent thereto, had visualized the vast possibilities of utilizing the Columbia River and harnessing the same, particularly at and in the area of the Priest Rapids to furnish irrigation for the adjacent lands lying to the east, to make the same productive for agricultural and kindred purposes, and with these objects and purposes in view, these plaintiffs made and caused to be made surveys, investigations, experiments, soundings and other determinations to determine the possibility and feasibility of diverting waters of the Columbia River to the area above referred to, to cause the same to be made productive and to generate power and electrical energy as above referred to, with the primary and principal end and object in view of making possible the irrigation of the lands above referred to, the increase in colonization, and the development of the territory

as an agricultural unit, and, secondarily, the object and purpose of these plaintiffs was to develop and utilize the said project for power purposes.

## IX.

With the primary end in view of developing [6] such territory for agricultural, industrial and kindred purposes, the individuals, Milton E. Dam and Everett S. Dam, brothers as aforesaid, organized and entered into a partnership agreement with each other, about the year 1905, and thereafter operated under the partnership name of Dam Brothers, and by contributions of their individual assets and holdings to said partnership, and through their individual and joint efforts, said Dam Brothers acquired and controlled a vast acreage in the territory described as the Priest Rapids Highlands Project, and through the efforts of such partnership there was brought under its control approximately one hundred thirty-five thousand (135,000) acres of land in such project, and representing approximately one thousand (1,000) landowners therein.

## X.

The Columbia River at the site of said Priest Rapids, and above and below the same, is and was a navigable river, and as originally contemplated by the plaintiffs, it was proposed to divert waters from such river for irrigation purposes, for which purpose it was and would not be necessary or required to establish more than water rights and did not and

would not be necessary to span the Columbia River with a dam or other obstruction to navigation.

## XI.

For a time, covering a period of approximately three (3) years prior to the year 1913, the defendant, General Electric Company, had under consideration the project of developing the Priest Rapids site on the said Columbia River primarily as a source of electrical power and energy, for which purpose it would be necessary to span the said Columbia River from bank to bank and construct a high dam across said river, which, as above set out, was a navigable stream and by reason thereof was under the control of the Federal [7] Government.

## XII.

In making its investigations and surveys to formulate plans to put into operation its proposed development of said Priest Rapids for power purposes, the General Electric Company learned that it would encounter considerable difficulty and run into obstacles, first, in that the plans and project of the plaintiffs, Dam Brothers, which had progressed to the point of realization within a very short time, were in conflict with the project and plans of the defendant, General Electric Company, and because of such conflicts the defendant, General Electric Company, would be unable to proceed with its project, and second, because of the fact that the Columbia River was a navigable stream and because of Federal laws then in effect affecting and

relating to power projects on and across navigable streams, the project and plans of the defendant, General Electric Company for the development of said Priest Rapids as a power site could not be advantageously accomplished, and was not feasible unless or until Federal laws affecting the development of the power site at Priest Rapids were changed or altered to make the plans and project of the General Electric Company feasible, principally as to the period or length of time for which a license or permit could be obtained.

### XIII.

On learning of these obstacles and the Federal laws restricting and affecting the development and prosecution of its plans and the project at said Priest Rapids, the defendant, General Electric Company, through its officials and agents approached and contacted the plaintiffs and proposed to the plaintiffs that they and the General Electric Company join their forces and resources for the joint development of said Priest Rapids project, both for irrigation and power purposes, and to that end a meeting was proposed by the General Electric Company and that the plaintiffs and said General Electric Company meet in a joint meeting [8] and conference to be held in the City of New York, New York, A.D., 1913, to work out and consider plans for the combination of the resources, plans, surveys and efforts on the part of the plaintiffs and the General Electric Company toward the development and utilization of said Priest Rapids as a joint or common

project by the plaintiffs and the said General Electric Company.

#### XIV.

During the period prior to the year 1913, while the defendant, General Electric Company, was making its investigations and surveys to determine the possibilities and feasibility of said Priest Rapids on said Columbia River for development as a power site, one Charles A. Coffin, who was one of the original founders of the General Electric Company and originally its president, and in the year 1913 and subsequent thereto was Chairman of the Board of Directors of said corporation, and who acted as spokesman for said corporation in the preliminary negotiations and conferences between these plaintiffs and said General Electric Company leading up to the formation of the joint venture agreement hereinafter alleged, stated and represented to these plaintiffs that the defendant, Electric Bond & Share Company, had been originally organized by the defendant, General Electric Company, and the General Electric Company owned all of the issued and outstanding capital stock, both common and preferred, of the defendant, Electric Bond & Share Company, and that through such original organization and the stock ownership, the defendant, General Electric Company, controlled and directed the corporate business, affairs and activities of the said defendant, Electric Bond & Share Company, through directors and officers trained, loyal to and historically connected with the General Electric Company, and selected, nominated and voted into of-

fice by the General Electric Company through its stock ownership and voting control of the defendant, Electric Bond & Share Company as the ostensible [9] management of said Electric Bond & Share Company, and the defendant, General Electric Company, and the said Charles A. Coffin in its behalf further stated and represented to the plaintiffs that because of the existing harmonious relationship between the two defendant corporations, and the domination and control of the General Electric Company over the Electric Bond & Share Company and the further fact that Electric Bond & Share Company maintained its own engineering, surveying, appraisal and other highly trained and technical staffs, the plaintiffs were requested by the said General Electric Company, and the said Charles A. Coffin in its behalf, in all things to consult, work with and negotiate with one Sidney Z. Mitchell, who was President and managing director and officer of Electric Bond & Share Company, which in turn was under the direction and control of General Electric Company.

## XV.

As the direct and proximate result of the consultations and negotiations carried on between the plaintiffs and the General Electric Company, in which the said Sidney Z. Mitchell participated, ~~a~~ an oral contract or agreement, in the nature of and constituting a joint venture was worked out, formulated and agreed upon between the plaintiffs on the one hand and the General Electric Company and its subsidiary and agent, Electric Bond & Share

Company, on the other hand, A.D., 1913, by Charles A. Coffin, Sidney Z. Mitchell and Henry Pierce, under the terms and conditions of which it was agreed between the parties, and each with the other agreed to do and perform the following acts and things and furnish to the other services, information and financial and other assistance as hereinafter set out.

## XVI.

In, by and under such joint venture agreement it was stipulated and agreed by the plaintiffs that on their part they would:

(a) Withhold, withdraw from and abandon plaintiffs' plans for the development which they proposed and had under [10] consideration at Priest Rapids and join the defendant, General Electric Company, and its subsidiaries, including the defendant, Electric Bond & Share Company, acting under the direction and control of said General Electric Company, and its agents, in a joint substitute plan for the single full development of the Priest Rapids area for irrigation and power purposes, for the joint benefit of plaintiffs and said General Electric Company;

(b) Aid and assist in securing favorable legislation through the Congress of the United States affecting the proposed power site on the Columbia River, which was a navigable river and under the then existing Federal laws no license or permit to cross or span the same with a dam for power purposes could be obtained for a period exceeding ten

(10) years, and to make the plans of the parties then under consideration, and to justify the vast expenditure of money which would be required to develop such project feasible, a longer period or term for such license or permit was imperative;

(c) Assist in securing additional power and industrial sites and lands which would be turned over to the defendant, General Electric Company, or to its subsidiaries or subholding corporations or agents as directed by it, for the purpose of constructing a dam for the generation of power and for irrigation purposes, upon the passage of favorable Federal legislation;

(d) Make available to the defendant, General Electric Company and its subsidiaries and/or subholding corporations or agents, as directed and requested by it, all of the plaintiffs' records, investigations, field logs, field work and knowledge of the plaintiffs as it related to resources, sources of minerals, building and other materials, as related to the development of power and for irrigation and other purposes;

(e) Jointly acquire with the defendant, General Electric [11] Company, or by or through its subsidiaries and agents as directed by it, fifty-five thousand (55,000) acres controlled by the plaintiffs and which was a part of the plaintiffs' original plan and project, which was railroad grant lands, and the parties would jointly work with and control such lands, and the plaintiffs would devote their efforts

toward the acquisition of or control over other privately owned lands and private landowners, and thereby protect the plaintiffs' original plans for irrigation and the said defendant, General Electric Company's, original plans for power development and industrial expansion;

(f) Employ plaintiffs' resources, connections and efforts to obtain favorable water power legislation in the Congress of the United States which would permit and make feasible the construction of a dam at Priest Rapids, and as a part of such campaign to create a demand locally, and throughout the state and nationally for such legislation.

## XVI $\frac{1}{2}$ .

In and by such joint venture agreement it was stipulated and agreed by and on the part of the defendant, General Electric Company, that it, directly or through its subsidiaries acting under its direction and control and in its behalf, would:

(a) Allot to the plaintiffs and they would receive five hundred thousand dollars (\$500,000.00) worth of common stock of a corporation to be known as the Priest Rapids Power Company which the defendant, General Electric Company, itself or acting through agencies directed and controlled by it would cause to be organized and incorporated with an authorized par value corporate stock of forty million dollars (\$40,000,000.00) upon the passage of favorable power legislation by the Congress of the

United States affecting the Priest Rapids power site;

(b) Plaintiffs were to be allotted, own and receive a thirty per cent (30%) interest in a land holding syndicate to [12] be formed immediately following the making and entering into of said joint venture agreement, which syndicate was to acquire the approximately fifty-five thousand (55,000) acres of land above referred to as railroad land grant lands, the affairs of said land syndicate to be jointly controlled by the plaintiffs and said General Electric Company, or representatives under its control;

(c) The plaintiffs were to have allotted to them and to receive a ten per cent (10%) stock interest in corporations to be formed to be known as the Terminal Townsite Company, and other companies, for the purpose and with the object of the development of industrial and transportation facilities in the immediate vicinity of and adjacent to said Priest Rapids site, which corporations were to be formed and organized upon and immediately following the passage of favorable Federal legislation affecting said Priest Rapids site, which was then within the contemplation of the parties, and the formation and incorporation of the said Priest Rapids Development Company above referred to;

(d) There was to be allotted to and received by the plaintiffs a ten per cent (10%) interest in any and all of the various syndicates or corporations to be formed or organized for the purpose of acquiring

or developing mineral rights, minerals, building materials and various other resources to be used and useful in connection with the development of said Priest Rapids and said Columbia River for power and irrigation purposes;

(e) The defendant, General Electric Company, itself, or through the defendant, Electric Bond & Share Company, owned, dominated and controlled by it, would furnish all funds and facilities to meet the expense to be incurred, and the moneys to be expended, and the activities to be performed during the preconstruction and construction period, and during the period of work and effort to secure favorable Congressional laws to make feasible and possible the development of said Priest Rapids as a power, industrial [13] and irrigation project, and the said defendant, General Electric Company, further promised and agreed with the plaintiffs that, it or through subsidiaries acting for it under its direction and control would institute and diligently prosecute all necessary activities and perform all acts necessary or required for the fruition and realization of the plans and prospects of the parties for the development of said Priest Rapids site for power and irrigation purposes.

## XVII.

In the making and entering into of said joint venture agreement as above set out, it was mutually agreed by and between the parties thereto that each

of the parties would advise with and consult the other in matters of general policy for the carrying out of such plans and developments and that each would consider and respect the suggestions of the others with reference thereto, and that the parties thereto would jointly control the operation of such joint venture.

## XVIII.

Thereafter, and following the formation of such joint venture, the plaintiffs on their part made available to the defendant, General Electric Company, and to its representatives and agents, and to the representatives and agents of subsidiaries under the direction and control of said General Electric Company, as directed by said General Electric Company, all of their records, investigations, reports, field logs and findings in connection with their field work, and disclosed to the said defendant and its said representatives, agents and subsidiaries as above set out, including knowledge and information with reference to minerals and mineral deposits, lime deposits, and deposits of a mineral or material known as and called "Tufa," which is a form of natural cement and useful and could be utilized in the construction of the proposed dam and other improvements in connection with such project, including irrigation flumes, and ditches, in connection with the proposed [14] dam and other improvements in connection with the proposed irrigation system, and the plaintiffs generally and in all things done and performed the said joint venture on their part to be performed.

## XIX.

In furtherance and as a part of the performance of the said joint venture agreement on their part to be performed, the plaintiffs contacted and caused to be contacted senators and representatives in the Congress of the United States from the State of Washington and other states interested in the development of hydroelectric power, and aided and assisted in furnishing information and in formulating legislation aimed at the passage of favorable legislation in said Congress which would permit the development of said Priest Rapids project for the development of hydroelectric power, and by contact with influential voters interested in the development of said Priest Rapids Highlands project, and kindred projects elsewhere in the United States, and secured their aid in the furtherance of such legislation, all to the end of the passage of such legislation.

## XX.

As originally proposed the said legislation contemplated only the development of hydroelectric power on navigable rivers and streams, and licenses and permits therefor to cover a period of fifty (50) years, but at the suggestion and upon the insistence of the defendant, General Electric Company, and its subsidiaries under its direction and control, and against the wishes of the plaintiffs, made an attempt to secure legislation which would cover the development of hydroelectric power not only on navigable rivers and streams, but also on nonnavigable rivers and streams, and would extend the life of the li-

censes or permits to a term of ninety-nine (99) years, which later proposed legislation, because of adverse pressure against the same, was [15] abandoned, and after a delay of some seven years, during which the 63rd Congress and until the 66th Congress convened and had such legislation under consideration, in March, 1920, such favorable water power legislation became law, during all of which time the plaintiffs were devoting their efforts in furtherance thereof.

## XXI.

In further performance of said joint venture agreement on their part to be performed, the plaintiffs acquired for the land syndicate formed for such purpose under the joint venture agreement, the fifty-five thousand (55,000) acres of land for irrigation, and other lands, some of which had previously been acquired by the defendant, General Electric Company, acting through a subsidiary controlled by it, and including lands to be included in the corporation Townsite Terminal Company above referred to. The plaintiffs further in the performance of said joint venture agreement on their part to be performed, at the request of and under the direction of the defendant, General Electric Company, and its agents, representatives and subsidiary corporations under its domination, direction and control, secured the above-mentioned Tufa deposits immediately adjacent to the proposed dam and townsite, in the contemplation of the parties, and which deposits it was agreed between the parties were to be turned over to a corporation to be or-

ganized as the Tufa Natural Cement Company, which was within the contemplation of such joint venture agreement.

### XXII.

After the passage of legislation favorable to the development of the Priest Rapids project by the Congress of the United States in 1920, the General Electric Company through its agents and representatives, and through its subsidiary, Electric Bond & Share Company, dominated, directed and controlled by the defendant, General Electric Company, and through its complicated [16] and confusing, and in some instances wholly fictitious, corporate setups, caused diamond drilling and other engineering services to be done and performed at the said Priest Rapids site, and in the vicinity thereof, for the purpose of making estimates and determinations as to the probable costs and specification necessary for the construction of such proposed dam and other improvements. Prior to such times the defendant, by and through one of its subsidiaries acting under its domination, direction and control had secured a permit and later a license to construct the proposed dam for the purpose of producing and manufacturing hydroelectric power at said Priest Rapids site.

### XXIII.

The said permit for the construction of said dam was granted about the year 1925, and at said time, by public declaration through the press and by private communication to the plaintiffs by and through the defendant, General Electric Company and its

subsidiaries acting under its domination, direction and control, affirmed and reaffirmed its intention to immediately proceed with the proposed project, and these plaintiffs believed and relied upon the statements and assurances so made by and under the direction of the defendant, General Electric, that such project would be pushed to full realization and fruition.

#### XXIV.

The said defendant, General Electric Company, to the knowledge of these plaintiffs, at no time abandoned the performance of such joint venture agreement on its part, nor did it notify the plaintiffs to that effect, but at all times advised and assured these plaintiffs that it still proposed and intended to proceed with the said proposed plans, but following the securing of such license, about the year 1929, the entire United States was in a depression following World War No. I, and following this the United States entered World War No. II, all of which [17] resulted in Government controls of metals and materials which would be needed and required in the prosecution of such development and project, and as a result thereof the said defendant, General Electric Company, was hampered and delayed in prosecuting and proceeding with the development of said Priest Rapids, but at all times the said General Electric Company advised and assured the plaintiffs that it fully intended to perform its part of said joint venture agreement, which advice and assurances the plaintiffs believed and relied upon.

## XXV.

Following the peace of World War II the subsidiary which the defendant, General Electric Company, had previously and publicly stated would build the Priest Rapids dam and furnish electrical power for the syndicated lands, secretly carried on negotiations for disposing of the large land holdings of the said land syndicate for a nominal sum, which sale was later completed without the consent of the plaintiffs, although formal protest against said sale was made by plaintiffs upon learning of the proposed sale, and which action placed the syndicate lands beyond the power of the defendants to perform the terms of such joint venture agreement on its part to be performed. At all times the plaintiffs served written and verbal notice on the defendants of their objections to any disposition of the said syndicate lands, either in whole or in part.

## XXVI.

In view of the facts which lead the plaintiffs to believe, just prior to the commencement of this action, that the defendants were starting to change the ownership of the properties in the state of Washington, and contrary to the terms and conditions of said joint venture agreement, and the performance of such acts and things would prevent and interfere with the defendants in performing the terms, conditions and agreements in said [18] joint venture, the plaintiffs, on or about June 14th, 1951, made written demand on the said defendant General Electric Company to complete and comply

with the terms and conditions of said joint venture agreement, or in the alternative to make settlement with and make the plaintiffs whole as the result of their losses, in money, time, effort and in all other respects by reason of the plaintiffs' changed position as the result of said joint venture agreement, and the efforts on their part to perform and fully comply therewith on their part, to which demand the said defendant, nor anyone for it made any response and this action was then instituted promptly.

## XXVI.

As the direct and proximate result of the defendants failure to perform and carry out the terms and provisions of said joint adventure agreement, and the necessary changes in position the plaintiffs were required to make and undertake on their part to carry out the said joint venture agreement on their part to be performed, and the time and efforts expended and the moneys paid out by them by the plaintiffs, in all things required of them to carry out their part of said joint venture agreement, the plaintiffs have been injured and damaged, and have materially changed their position to their detriment in the following particulars:

1. Priest Rapids Power Company common stock .....	\$ 500,000.00
2. 10% interest in Townsite Terminal Company, common stock ....	250,000.00
3. 10% interest in limestone company, construction supply, chemical works, etc.....	100,000.00

4.	30% interest in Tufa Natural Cement Company, common stock . . .	50,000.00
5.	Hydro-chemical operations . . . . .	90,000.00
6.	Reasonably anticipated profits and returns from the development of materials, electrical furnace, chemicals, industries and wood products	300,000.00
7.	Land—syndicate 50,000 acres (3 rural townsites, completely engineered project, 30% of total profit	900,000.00
8.	Engineering 135,000 acre project—power, irrigation, etc. . . . .	250,000.00
9.	Privately owned lands, Highlands	750,000.00
10.	Office, laboratory, ranches, equipment, livestock, homes, automobiles, etc. . . . . .	160,000.00
11.	Mines, mineral lands, research engineering, professional records, maps, and reports . . . . .	200,000.00
		<hr/>
		\$3,550,000.00

and in addition thereto the plaintiffs have suffered further damage as the proximate result of the defendants' breach of the said joint venture agreement, as hereinabove alleged, and the loss of finances, credit and engineering and business opportunities, loss of business and professional records and prestige, and the utilization of the plaintiffs' knowledge, experience and training, and loss of opportunities by the plaintiffs. the plaintiffs have been injured and damaged in a sum of not less

than five million dollars (\$5,000,000.00), or a total of \$8,550,000.00.

For a Second Cause of Action, Plaintiffs Complain and Allege as Follows:

### I.

Repeat, reiterate and reallege all of the allegations, matters and things set forth in the foregoing First Cause of Action as fully and with the same effect as though set forth herein and hereat.

### II.

The defendants used and employed the knowledge, experience and efforts of the plaintiffs during the period covered by said co-adventure, and as a result thereof obtained favorable legislation, as hereinabove set out and other advantageous positions and situations, and as a result thereof the defendants have secured and obtained enormous profits through the [20] expansion of their facilities, and the defendants did and have made use of, for their own benefits, the various accomplishments of the plaintiffs, in procuring for the defendants great and immense profits and expansion of their various enterprises, which cannot now be determined by these plaintiffs.

For a Third and Further Cause of Action Against the Defendants, the Plaintiffs Complain and Allege as Follows:

### I.

The named defendant corporation, Electric Bond & Share Company, because of its participation, ac-

tivities and financial investments and support in connection with the limited performance of the said Joint Venture agreement on the part of the defendant General Electric Company, all as hereinabove set forth is a proper party defendant to this action, and, in the event it shall determine or desire to appear herein and assert or have determined any alleged rights, claims or remedies it may have or claim against the plaintiffs or its co-defendants, such rights, claims or remedies may be asserted or determined in this action, but in the event it shall elect or determine not to appear herein or assert or have determined any such claimed rights or remedies, the final determination of the matters in controversy as between these plaintiffs and the said General Electric Company can be had herein without injuriously affecting the interests of the defendant corporation, Electric Bond & Share Company, and without leaving the controversy involved herein in such situation that its final determination as between the plaintiffs and the defendant General Electric Company may be inconsistent with equity and good conscience.

Wherefore the plaintiffs pray:

1. That the court find and determine that the parties hereto made and entered into a joint venture agreement as herein set forth; [21]
2. Finding and determining that the defendants, and in particular the defendant General Electric

Company has wholly failed, neglected and refused to complete, carry out and perform the terms and conditions of said joint venture agreement, and by its acts and actions has put it beyond its power to so perform said joint venture agreement;

3. That because of the failure, neglect and refusal of the said defendants, and particularly the defendant General Electric Company to complete and comply with the terms, conditions and agreements contained in said joint venture agreement, the plaintiffs have materially changed their position, financially and otherwise, and have been injured and damaged thereby in the sum of not less than Eight Million Five Hundred Fifty Thousand and no/100 (\$8,550,000.00) Dollars which sum the plaintiffs are entitled to recover from the defendants, jointly or severally;

4. That the Court make such other or further order, judgment or decree as shall be mete and just in the premises, including judgment for the costs and disbursements of this action.

PHIPPS & PHIPPS,

By /s/ HARVE H. PHIPPS,  
Attorneys for Plaintiffs.

[Endorsed]: Filed November 5, 1953. [22]

[Title of District Court and Cause.]

## ORDER QUASHING SERVICE AND DISMISSING ACTION

The defendant Electric Bond & Share Company's motion to dismiss the action or to quash the return of service of summons having been noticed for hearing and heard on the 17th day of November, 1952, plaintiffs appearing by R. Max Etter and Harve H. Phipps and defendant appearing by Paine, Lowe & Coffin, their respective attorneys, the Court being advised in the premises, now

Orders that the motion to quash the return of service be granted and that the plaintiffs' action against the defendant Electric Bond & Share Company be dismissed without prejudice.

Dated this 21st day of November, 1952.

Enter:

/s/ SAM M. DRIVER,  
Judge.

Presented by :

/s/ WM. S. PAYNE.

O.K. as to Form:

/s/ R. MAX ETTER.

[Endorsed]: Filed November 21, 1952. [23]

[Title of District Court and Cause.]

**ORDER QUASHING SERVICE AND  
DISMISSING ACTION**

The defendant American Power & Light Company's motion to dismiss the action or to quash the return of service of summons having been noticed for hearing and heard on the 16th day of January, 1953, plaintiffs appearing by R. Max Etter and Harve H. Phipps, and defendant American Power & Light Company appearing by Paine, Lowe & Coffin, their respective attorneys, the Court being advised in the premises, now

Orders that the motion to quash the return of service be granted and that the plaintiffs' action against the defendant American Power & Light Company be dismissed without prejudice.

Dated this 9th day of April, 1953.

Enter:

/s/ SAM M. DRIVER,  
Judge.

Presented by:

/s/ WM. S. PAYNE.

O.K. as to Form:

/s/ R. MAX ETTER.

[Endorsed]: Filed April 9, 1953. [24]

[Title of District Court and Cause.]

MOTION TO MAKE SECOND AMENDED  
COMPLAINT MORE DEFINITE AND  
CERTAIN

Plaintiff's second amended complaint is so vague and ambiguous as to defendant General Electric Company, that said defendant should not reasonably be required to prepare a responsive pleading, and said defendant therefore moves that plaintiffs be ordered to furnish a more definite statement of the nature of their claims as set forth in their complaint in the following respects:

I.

Paragraph IX, line 9, page 7 by stating in what manner the partnership brought under its control approximately 135,000 acres of land and whether or not the same was oral or written, and if in writing to set forth a copy thereof.

II.

Paragraph XIII, line 8, page 8, by stating in what manner the plans of Plaintiffs were in conflict with the project and in conflict with the plans of the General Electric Company.

III.

Paragraph XIII, line 26, page 8, by stating what officials and agents of the General Electric Company contacted the Plaintiffs and by stating the date it was proposed to the Plaintiffs that they and the

General Electric Company join their forces and resources for the development of the Priest Rapids project, and whether or not said proposal was oral or in writing, and if in writing to set forth a copy thereof. [25]

#### IV.

Paragraph XIV, line 19, page 9, by stating the date of the alleged representations, whether the same were oral or in writing and if in writing to set forth a copy thereof.

#### V.

Paragraph XIV, line 3, page 10, by stating whether the alleged representations to the plaintiffs were oral or in writing, and if in writing to set forth a copy thereof.

#### VI.

Paragraph XIV, line 17, page 9, by specifying the dates and places of the alleged conferences and the names of the parties present.

#### VII.

Paragraph XIV, line 9, page 10, by stating whether the request by the said General Electric Company referred to was oral or in writing, the date thereof, and if in writing to set forth a copy thereof.

#### VIII.

Paragraph XV, line 20, by stating the date of the alleged joint venture agreement and by stating whether or not the agreement was oral or in writing and if in writing to set forth a copy thereof and by further stating what officer or agent entered into

said contract for and on behalf of the General Electric Company.

### IX.

Paragraph XVI, line 24, page 12, by stating whether the Priest Rapids Power Company was incorporated.

### X.

Paragraph XVI, line 31, page 12, by stating whether the land syndicate was formed, and if so, the name thereof, the names of the members comprising the same; by stating whether or not the plaintiffs received a 30% interest therein. [26]

### XI.

Paragraph XVI, line 9, page 13, by stating whether the Terminal Townsite Company was organized.

### XII.

Paragraph XVII, line 10, by stating whether the mutual agreement referred to was oral or in writing and if in writing to set forth a copy thereof.

### XIII.

Paragraph XVIII, line 20, page 14, by stating the name of the representatives and agents of the General Electric Company and also the names of the representatives and agents of the subsidiary under the direction and control of the said General Electric Company, to whom the plaintiffs made available all of their records, investigations and reports and the dates and places where said records

were made available, and also the name of the subsidiary referred to.

#### XIV.

Paragraph XX, line 24, by stating whether the suggestion of the defendant General Electric Company was oral or in writing, and if in writing to set forth a copy thereof and by naming the subsidiaries alleged to be under its direction and control.

#### XV.

Paragraph XXI, line 9, page 16, by setting forth the name of the land syndicate referred to, the members thereof and when organized.

#### XVI.

Paragraph XXI, line 12, page 16, by naming the subsidiary alleged to be controlled by the General Electric Company and by stating the manner in which said subsidiary was controlled by the General Electric Company.

#### XVII.

Paragraph XXI, line 18, by stating the names of the agents and representatives of the General Electric Company referred to and the names of the subsidiary corporations alleged to be under the domination, direction and control of the General Electric Company. [27]

#### XVIII.

Paragraph XXI, line 20, by stating when the plaintiff secured the Tufa deposits referred to, the name of the individual or company acquiring title

to the same, and the name of the officer or agent of the defendant General Electric Company who requested the plaintiffs to secure said deposits.

### XIX.

Paragraph XXII, line 2, page 17, by stating who caused the diamond drilling and other engineering services to be performed at the Priest River site.

### XX.

Paragraph XXII, line 9, page 17, by stating the dates of the permit and license and in whose name the same were issued.

### XXI.

Paragraph XXIV, line 28, by stating what officers or representatives of the General Electric Company advised and assured the plaintiffs that they proposed to proceed with the proposed plans and whether such advice and assurance was oral or in writing, the date thereof, and if in writing to set forth a copy thereof, and that the same showing be made with respect to the alleged assurance given to the plaintiffs as alleged in line 6 in the same paragraph on page 18.

### XXII.

Paragraph XXV, line 11, by stating the name of the subsidiary which the defendant General Electric Company had publicly stated would build the Priest Rapids Dam, and by stating where and when the General Electric Company made such announcement, and the form thereof.

## XXIII.

Paragraph XXV, line 17, by setting forth the date of the alleged sale and also the date of the protest made against the sale by plaintiffs and whether oral or in writing and if in writing to set forth a copy thereof and by setting forth the written notice referred to in line 23 of said [28] paragraph.

## XXIV.

Paragraph XXVI, line 12, page 20, by separately setting forth the nature and amount of finances, credit, engineering and business opportunities, business and professional records and prestige alleged to have been lost by the plaintiffs.

## XXV.

Paragraph II, of the second cause of action, line 32, page 20, by stating the amount of profit alleged to have been secured and obtained by the defendant, and line 2, page 21, by setting forth the various accomplishments of the plaintiff which the defendants used for its own benefit.

/s/ PHILIP S. BROOKE,

HAMBLEN GILBERT &  
BROOKE,

Attorneys for Defendant Gen-  
eral Electric Company.

Service of Copy acknowledged.

[Endorsed]: Filed August 25, 1955. [29]

[Title of District Court and Cause.]

### MOTION TO STRIKE

Comes now General Electric Company, defendant above named by its attorneys, and moves the court for an order striking the following portions of the Second Amended Complaint on file herein, upon the ground that the same are irrelevant, redundant and immaterial:

#### I.

Paragraph V and the whole thereof. In the event said motion is denied as to the entire paragraph, defendant moves that all that part of said paragraph commencing with line 29, page 3, to the end of the paragraph be stricken.

#### II.

Subparagraphs 1 to 11, inclusive, of paragraph XXVI and lines 10 to 18, inclusive, of paragraph XXVI on page 20.

#### III.

Paragraph II of plaintiffs' Second Cause of action, and each and every part thereof.

#### IV.

Paragraph I of plaintiffs' Third Cause of action, and each and every part thereof.

This motion is based upon the files and records herein.

/s/ PHILIP S. BROOKE,  
HAMBLEN GILBERT &  
BROOKE,  
Attorneys for Defendant Gen-  
eral Electric Company.

Service of Copy acknowledged.

[Endorsed]: Filed August 25, 1955. [30]

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[Title of District Court and Cause.]

#### MOTION TO DISMISS

Defendant General Electric Company moves the Court as follows, with reference to Plaintiffs' Second Amended Complaint herein:

##### I.

To dismiss the above-entitled claim as to the General Electric Company for the reason that said Second Amended Complaint fails to state a claim against said Defendant upon which relief can be granted.

/s/ PHILIP S. BROOKE,  
HAMBLEN GILBERT &  
BROOKE,  
Attorneys for Defendant Gen-  
eral Electric Company.

Service of Copy acknowledged.

[Endorsed]: Filed August 25, 1955. [31]

[Title of District Court and Cause.]

(Copy)

### AFFIDAVIT

State of California,  
County of Placer—ss.

I, Milton E. Dam, being first duly sworn, depose and say that he is one of the Plaintiffs;

That he has directly carried on the activities pertaining to this action;

That it is appreciated that this petition and appeal may not be in strict accordance with the usual Court procedure covering such steps, but it is believed that the Court will understand in view of the circumstances pertaining to this Case since the filing, together with the following facts;

That it is desired to meet only the present matter of Notice issued by your Court under date of August 11, 1955, presenting the conditions upon which this appeal and request is made and under which true circumstances it is believed consideration by your Court is justified;

That the undersigned, due to circumstances, occupies the position of having carried on almost alone the enormous work and activities covering this gigantic affair, particularly since filing the action;

That because of the strain and unnatural nervousness to the extreme with the added burden during

this last period, had a case of fighting a complete nervous breakdown, and was forced not long ago to come south in an endeavor to recover a more normal condition; [32]

That there has not been and is not now any element of purposely delaying or prolonging this action in question;

That there are certain conditions and phases pertaining to the carrying on and confident assurance of a satisfactory completion and adjustment of this substantial affair, which of course the Court has probably no knowledge;

That there is no desire to burden the Court with any excess explanations, only true and factual reasons for the matter of elapse time element;

That it is not unreasonable to understand and believe that with the Plaintiffs in the 70th Year Bracket, with the loss of their former associates and close business acquaintances, that Plaintiffs would not purposely prolong this matter;

That Plaintiffs are not living for the future but for the very present, time is very dear and precious to them;

That thousands of dollars of expenditures and a long time was devoted in preparing the material for this matter, that a more complete and hundreds of documents and exhibits making up the continuous

and connecting material was never equaled in the history of our State in legal records;

That the undersigned had charge of this tremendous work and task, and it is now evident that he tried to hold on and put off too long to make the beneficial move to recover;

That by the same Heavenly Power Above that has made it possible for Plaintiffs to endure and survive the long period of suffering and ruinous losses, will give us strength to carry this matter on, with full confidence for the rightful outcome;

That the Opposition has been in harmony, to undersigned last knowledge, with the unintentional lapse of time in this matter, that they are the gainer with the Plaintiffs the loser with this unfortunate lost time element;

That this matter represents the entire life and work and endeavor of the Plaintiffs, that it would be disastrous for any drastic action to change the present legal status of same;

That because of the above circumstances and undersigned being far away from Counsel and unable to personally confer, this appeal is being written and forwarded unaided to your Honor and Plaintiffs pray that same will be carefully considered and accepted as the true facts and statements covering the matter.

/s/ MILTON E. DAM.

Subscribed and sworn to before me this 30th day of August, 1955.

[Seal] /s/ MARY ELIZABETH  
MONCHAMP,  
Notary Public for California.

My Commission expires February 25, 1958.

Receipt of Copy acknowledged.

[Endorsed]: Filed September 2, 1955. [33]

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United States District Court, Eastern District of Washington, Northern Division

Civil No. 1036

MILTON E. DAM, et al.,

Plaintiffs,

vs.

GENERAL ELECTRIC COMPANY, a Corporation,

Defendant.

RECORD OF PROCEEDINGS AT  
HEARING ON MOTIONS

Be It Remembered that the above-entitled cause came on for hearing at Spokane, Washington, on Wednesday, September 7, 1955, before the Honorable Sam M. Driver, Judge of the above-entitled Court, the plaintiffs being represented by Harve H. Phipps, of Spokane, Washington, the defendant being represented by Phil S. Brooke, of Spokane,

Washington; Whereupon, the following proceedings were had, to wit:

The Court: I will take up the motions in the Dam case first, then. [65\*]

Mr. Brooke: May it please the Court, your Honor may recall that heretofore on behalf of the General Electric Company, we briefly argued the motion to dismiss on the grounds that there are indispensable parties not before the court, also the question of the statute of frauds, and also the question of laches, which your Honor held that matter in abeyance pending his ruling on the motion to dismiss the Electric Bond and Share Company, which was subsequently granted and they are out of the case.

Your Honor may recall that this action originally started out claiming a joint adventure agreement between the Dam brothers and General Electric, the American Power and Light, and the Electric Bond and Share. They were unable to get service on the American Power and Light, so they dropped out of the picture; the Electric Bond and Share Company has been dismissed from the action; but, nevertheless, the complaint still alleges a joint adventure agreement was worked out formally and agreed upon between the plaintiffs on the one hand and the General Electric Company and its subsidiary and agent, Electric Bond and Share Company, on the other hand, under the terms and conditions of which it was agreed between the parties that each with

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\*Page numbering appearing at the foot of the original certified Supplemental Transcript of Record.

the other agreed to do and perform the following acts and things. This alleged joint adventure agreement was entered into in 1913. [66]

Now, then, we have presented herewith our authorities, and I am not going to refer to them because I presume the Court will wish to examine the briefs. Counsel for the plaintiffs have also submitted a brief. But we have a brief which presents the proposition that a joint adventure is nothing more or less than a partnership, except for a specific purpose, and there are some respectable authorities cited here to the effect that in an action of this kind, which is in the nature of an accounting, it is necessary that all parties to the joint adventure agreement be before the court. Otherwise, complete accounting cannot be completed as to all of the parties. And we have cited any number of authorities on that position.

So our first point is that there are indispensable parties, namely, the Electric Bond and Share and also the American Power and Light, which are not before this Court.

Jurisdiction could be had of all of these defendants in the jurisdiction of New York, so the plaintiff is not without a remedy.

Now, the second point is that it appears from the face of the complaint that a contract was entered into which is void under the statute of frauds, in that it could not possibly be performed within a period of one year. The complaint alleges that the agreement was entered into in 1913; that it would be necessary to secure federal [67] legislation to

build these dams. The legislation was finally enacted in 1920, a permit was issued in 1925, and then nothing was done. As a part of the project, they were to irrigate over 155,000 acres, just inconceivable, and besides build this dam, the Priest Rapids.

Now, it is just inconceivable to me that a project of this magnitude could be completed within one year, and the courts have held and the authorities I have cited here that the court may take into consideration all of the circumstances and the intention of the parties as disclosed from the alleged contract as to whether or not the contract was to be completed within one year. So this seems to me inconceivable that the parties ever intended that this contract should be performed within one year and, therefore, it is in contravention of the statute of frauds.

Point 3 is that the plaintiffs are guilty of laches. As I say, it has been nearly 40 years since this alleged agreement was entered into. It has been practically 30 years since the permit for the dam was issued and nothing has been done, and these parties have sat idly by and haven't enforced any of their rights in the matter, if they have any.

Now, then, there is a very excellent Washington case where the parties sat by, and, mind you, there is no allegation here of fraud or anything of that kind; it is [68] just failure to carry out an alleged agreement; and there is a very excellent Washington case where the parties sat by for a much less period than this—

The Court: I think that is cited in your brief, Mr. Brooke.

Mr. Brooke: Yes, *Teeter v. Brown*, 130 Washington, 506, which is a leading case, and briefly reading from that:

"Where a case is of purely equitable cognizance, in the application of the doctrine of laches, courts of equity act upon their own inherent doctrine of discouraging, for the peace of society, ancient demands, and refuse to interfere where there has been gross laches in prosecuting the claim or long acquiescence in the assertion of adverse rights. In such cases the statute of limitations does not necessarily govern the court in the application of the doctrine of laches. Regard must be had to all of the facts and surrounding circumstances, and if, when carefully considered, they do not appeal to the conscience of the chancellor, on behalf of a claimant, the defense of laches should [69] be allowed."

Now, just consider the position that the defendant is in in this case. All of the men referred to—they refer to Stanley Coffin in there as representing the General Electric, refer to a man by the name of Mitchell representing the Electric Bond and Share—those men have been dead for many years. There are absolutely no records on this thing whatsoever that we have been able to find. Of course, that is a matter of proof and probably outside the record, but you can easily conceive when time has been permitted to lapse like it has in this case that we have been greatly prejudiced by this action.

Now, ordinarily, the doctrine of laches is similar

to estoppel and it must be shown that a person relying upon it has been prejudiced, but I think it is self-evident that we have been greatly prejudiced by the fact that these men have taken no affirmative action for all of these years.

Now, then, counsel just served a brief on me this morning and I haven't, of course, had time to answer it, and he raises this question, that under the procedure in the Federal court, the question of statute of frauds or the doctrine of laches cannot be raised on the motion to dismiss, it must be pleaded affirmatively. But in my hasty examination of Barron and Holtzoff, Volume I, Section 281, [70] they say it may be raised where it appears on the face of the complaint, and there is also a case in 174 Federal (2d), 1003, in which it is held that if the defect is apparent from the face of the complaint, the doctrine of laches, statute of limitations, and so on, may be raised by motion.

The Court: Let's see, what was that page number? 104 Federal (2d), page what?

Mr. Brooke: 174 Federal (2d), 1003, Seventh Circuit.

The Court: Yes, all right.

Mr. Brooke: And then Barron and Holtzoff, and then I find any number of Washington cases which support the proposition that if the complaint on its face shows the plaintiff is guilty of laches, that a demurrer is the proper method of attack, and that principle should apply, I think, to the motion of dismissal. It is substantially the same as a demur-

rer, I believe, and there are a couple of Washington cases on that. In 75 Washington, 212:

"If the pleader sets out a contract that is within the statute of frauds, the defendant may properly demur or he may answer setting up the bar of the statute."

And then also in 30 Washington, 622, and 15 Washington, 57:

"Subject of demurrer if the complaint on the face shows plaintiff guilty of laches."

As I say, this matter on the first point about the [71] indispensable parties has been argued a couple of times to your Honor, and I am not going to take any longer time. There are extensive briefs on file covering both situations.

But I think for three reasons the motion should be granted; namely, there are indispensable parties who are not before the court; two, the contract violates, is void, under the statute of frauds, because it was inconceivable that this contract could be performed within one year; and the third point, that the plaintiffs are guilty of laches in letting all this time go by to the great prejudice of the defendant.

Mr. Phipps: If your Honor please, I think this is one of the most important cases that ever came before this Court, and never a case just like it.

In the complaint we allege that the joint venture deal was made with the General Electric after a lot of negotiating and after the Dam brothers had laid the foundation for a great development down there on the Columbia River, and there are certain

things that the Dam brothers were to do, commencing as young men, raised down there and their father, I believe, lived there, and they had built up this place to the point where they had control, virtually, of Priest Rapids. The General Electric just across the river had a large body of land and certain rights. The [72] Strahorn interests had certain rights up above them on the other side of the river, also. But all of the irrigable land and all of the advantages to get to the river and get to the site were controlled by the Dam brothers. They had put in their lifetimes there working this up to the point where they could develop the community there, and then according to the complaint here, the General Electric, who had already been negotiating a long time and who had obtained control of a large body of land there, we claim that they came along and said: "Now, here, we want you folks to come in with us because we are interested in power. We are not so much interested in all of the other things, of building a smokeless city, and so on, but we are interested in that, also, but essentially power."

But at that particular time, the Army Engineers had control of the navigable streams, on account of the fact that the power companies had been rather greedy, I presume, and the Army Engineers had been authorized to and they had made a rule that they would not grant a permit for power purposes for more than ten years. Naturally, ten years was a very short period of time on which financing could be done.

So the General Electric people, who had already

been there, who controlled everything all these years, once in a while through a little subsidiary, like a fingernail on the little finger, holding title and things of that kind [73] after they found out that the Dam brothers were in control of Priest Rapids and all of the high land there, consisting of about 150,000 acres in that cove surrounded by the Rattlesnake Hills on the west, running north and south, the Rattlesnake Hills running north and south, then the Umptanum Hill connecting as an elbow around to the gap which cut through, where the river cut through the Saddle Mountains there, and then the Saddle Mountains for 30 Miles east and then at the east end of the 30 mile distance a curve there back south, making a cove in there, one of the finest places in the world to develop a venture of this kind, so they virtually laid down on the Dam brothers to obtain this legislation and Senator Wesley L. Jones fathered the legislation through the Congress of the United States. Nobody would ever question Wesley L. Jones on anything, if he knew what he was doing.

All right, it took the General Electric, with all the forces of a thousand land owners down there, the association or the organization controlled—developed and controlled by the Dam brothers over a period of a long time—it took all of that land owners association and all of the forces of the Dam brothers and the force of Senator Jones to get that legislation through, and that took seven years.

The General Electric wanted 99 years, and there is the only disagreement that has ever come up between the Dam brothers and the General Electric

during that time. The [74] Dam brothers thought they should accede to the 50 year period and go ahead with the project. So they stalled along for seven years and finally the bill was passed, and the pen with which the bill was signed by the President of the United States was presented to Milton Dam, and that ought to be sufficient to show the great importance of this Dam organization, the Priest Rapids Highlands organization, and the farmers' organization there in getting this legislation through.

Now, immediately on the passage of that legislation, the General Electric began to do some diamond drilling down on this project, but they scattered their energies over the United States in about 265 different places, and because of the fact that they could get easier picking in all of the smaller places where they would have absolute control themselves, they neglected this place, and your Honor has read many, many, many times in the general public news where the General Electric is going to do this at Priest Rapids and General Electric and General Electric, and so on.

The W. I. & D. are the little holding company down there that has never had a dollar in this project. It has been just a hand or rather a finger of the General Electric. There has never been anything said about that. There was never anything said by the Electric Bond and Share, who was the company that was wholly owned by the General [75] Electric, every single share. They wanted some means of contacting the public and the General

organized the Electric Bond and Share and did all there was to it and trained their men in the General Electric and set them over the Electric Bond and Share and owned every single share of stock in that company until the S.E.C. told them to distribute that stuff to the stockholders of the General Electric.

Now, then, I think it makes but little difference whether the General Electric owned the Electric Bond and Share by a stock ownership or whether their stockholders owned the interest in the Bond and Share, so the laches here is 100 per cent on the part of the G.E. Here are two men that have lived and worked and entertained these men on their place out there at Priest Rapids. Their pictures are there. They have come out from the Electric Bond and Share, the General Electric, and those companies there that were interested in this great project and surveyed the possibilities there and planned the building of three towns and a smokeless city and bringing in the Milwaukee and the telephones and everything of that kind.

Now, that was a wonderful place over in there that was hidden. It was the Garden of Eden that was hidden from the world, and these Dam brothers went in there over Saddle Mountains, it is just a sheep trail virtually, and [76] they hauled these people over in there and worked on these plans and did everything in the world that they were to do. They have surveyed every foot of that ground for 30 miles. They have got the brass tops and signs and the iron posts for every 40-acre tract and every

160-acre tract for 30 miles long, costing hundreds of thousands of dollars and taking years of time and spending their lives.

Now Mr. Dam and the Dam boys are in the matured end of their lives and they are in physical condition which means virtual exhaustion in working out this project here, and these people should be required to come in here and say, "Now we did what we agreed to do" or admit that they didn't do it, or they should say to us that the Dam boys didn't do what they agreed to do.

We have set out in our complaint here the general setup of the General Electric there, which is, I will say, the golden pot that was back of this whole scheme, because they wanted to sell their products and they had to have these channels through which they could work, and the S.E.C. has found that these little trickling down 265 projects from the South and the East and the West and everywhere were just instrumentalities ultimately reaching back to the General Electric Company, and they had obtained control of 95 per cent of the business of this country through that method.

Now, all we are asking the General Electric to do [77] is to come along here and account to us, and I don't need to make any account, but to pay us the damages we have sustained because of spending our lives down there and now getting to the end of life with nothing in hand and the General Electric taking advantage of that, and under especially one clause of the contract here in regard to

profits that they should not have made, that they have unfairly made, and these facts alone ought to be sufficient to pronounce this a joint venture agreement in which these people should respond, and that is that when they started, when this bill was passed by Senator Jones—I have his picture where he is speaking and leading the fight for this bill for the farmers, for irrigation principally, because your Honor understands the law in regard to the first call upon the waters of this country for agricultural purposes—and this company laid down and utilized their subsidiaries and depended on the Dam brothers and their farmers' organization, and the papers have been full of it, and Jones made those speeches before the Congress of the United States that it was for agricultural purposes first of all, but the G.E. was interested in power and they took on these extra things, not particularly because they wanted to, but because it served their purpose in getting control of about 60 per cent of the advantages at Priest Rapids.

Now, these men have done. I have set out in [78] this complaint here what the Dam brothers were to do. I would like for them to come along now and show us what we haven't done. We set out also, if your Honor please, what the General Electric were to do. I would like to let them come in now and say we did this or we didn't do that.

The very same grasshoppers, if your Honor please, are sitting on the bushes up on that hill now. You can't tell any difference in the territory there at all. They did do a lot of diamond drilling, but they

got all their money back, no doubt, from deductions in their income taxes and things of that kind, and a large sum, I understand, was deducted on account of the Priest Rapids.

Now, the Priest Rapids have not been helped by anything that they have done. The same rocks are there that fell out of that gap and they are scattered, laying solid. I hope your Honor has been down there and seen it. I have. But for two miles to three miles down the river that 1,500 feet of a gap or a gate has broken out and broken to pieces and scattered down for several miles along the river. No doubt when that gap was in there, that Quincy Valley was under a lake, under water. Have to be, 1,500 feet up there, the Saddle Mountains, and then you go right off 30 miles to the east there and it surrounds the very land, 150,000 acres, one of the most beautiful spots in this world.

Now, then, if they had gone ahead and just drilled [79] in there or cut in a little canal over to the edge of that mountain and then pumped that water about 150 feet, just from the level of the river, the natural flow coming in under these state laws that permitted the Dam brothers to do what they were planning on doing, and pump it up there just a little ways to the level of that great flat there and then a canal along the south line of the Saddle Mountains, they figured about \$80 an acre to irrigate.

Now, if your Honor please, the present system is coming 160 miles, and they are putting a hole

through the Saddle Mountains in order to legally bring that 150,000 acres into the great scheme of the Coulee Dam irrigation system.

I was in the Legislature and I met these Dam brothers a way back there and I got the first bill through for the survey, Quincy Valley Survey, it is in the library, and I have watched that all these years and this should never have been a part of it, it should have been developed according to what the Dam brothers advised in the first place and like the General Electric planned in the first place, and that 150,000 acres as an independent project there could have been irrigated for one-fifth what it is costing to irrigate by running a canal 160 miles and then putting a tunnel through Saddle Mountains.

Now, then, all we want these people to do is to [80] come in and answer and show us, show the Court, that they have done anything except very superficial work there in doing some diamond drilling and the camouflaging the ownership there, and whenever the General Electric would come out and talk about it, the papers would say General Electric is going to do this and General Electric is going to do that.

Now, then, these instruments here, they have set out, the Electric Bond and Share, to tap the public of their money and they sure did it and they have paid the public their little 6 per cent and they have increased their assets now around, we'll say, I am not sure of this, but around twenty-five million, at the time that bill was passed, in about 20 years time they had increased their holdings in these 265 companies up to three billion dollars. No telling where

they are now. But three billion dollars on top of a few million dollars that they had in the first place.

Now, then, there isn't a question in this world, and anybody that will read the record and study it will have to find and go down and see the country there, will have to find that, and they won't even deny it, that this bill was put through on the reputation and on the standing of this landowners' organization which was represented by Dam brothers, and if it hadn't been so, if Dam hadn't been recognized as the leader in getting that legislation through for them, the President of the United States wouldn't have given him the [81] pen with which he signed the bill.

Now, that is one thing. The other key thing is that they have profited by the Dam brothers' work there, based on this assumed development of the country there for agricultural purposes, first of all. It was not first in the mind of the General Electric, but they made the Dam brothers feel that they could come in there and put in the power and then sell the power at a special contract to the Dam brothers with which a modern city, in other words, a smokeless city, could be built and that country developed there to unending values. The amount that is demanded in this complaint here, it is specified that is just underestimating what could be imagined, because a 2 per cent commission on the profits that the General Electric has made, based on the development that come after this bill was passed, would amount to more than we have asked for, and we would like for them to answer.

There isn't a question. If this isn't a joint venture deal here, then it just seems to me that we ought to quit discussing joint ventures and say that there is nothing of the kind. Where is there a single act of any of these companies, General Electric included, Electric Bond included, American Power and Light included, W. I. & D. included, where is there one single thing that they have done that would indicate that it is a partnership? If they [82] were to get this thrown into the idea of a partnership business here, then these accountings come in here and the endless litigation and the endless questions that they can raise would keep the Court busy for a long time and probably keep us busy until we would go over the hill.

I think that the proper thing to do is for them to come in here and answer this, or this is one thing, and I am not holding anybody else responsible, this is wholly from myself. I feel and I have felt, and that is one reason, if your Honor please, that this case has been drifting a little bit, just two reasons why it has been drifting: One was a very, very severe nervous breakdown on the part of Mr. Dam, and I couldn't even get in touch with him for a long time and his mail stayed in the mailbox here so long that I became uneasy about the situation and I went to the F.B.I. to help me find Mr. Dam. Now, then, Mr. Dam is recovering from his illness and he will be here ready for trial. But, if your Honor please, this is what ought to be done. There is a chance that it might be done, and I am certainly not suggesting that anybody else has waved any encouraging flags in my face. I don't want it to

appear that way, but I think this: That if the case remains status quo and the Court would be good enough to peruse these briefs on both sides, all of them, all of the briefs from every possible angle, that the Court will find that it is [83] one of the cleanest cut joint venture agreements that has ever been presented to this Court. The Court can find, and clearly so, that the Dam brothers have done everything that they have agreed to do, even their surveys of every acre of that land, with books as long as this desk almost, costs of hundreds of thousands of dollars, and they have done that and they have done it at a risk of all in this world that they had, and Mr. Dam was called back by the General Electric in connection with this bill there and kept in Washington a large portion of the time during more than seven years.

We have all the proof in the world that they laid down on the Dam Brothers and on the association here to get their bill through. Then when they got the bill through, they were so interested in this little spot and that little spot, 265 altogether, and in the S.E.C. Volume XI, you will find that the S.E.C. made up a little picture that is very clear in my mind where they put the ultimate control back here at the Electric Bond & Share, which was owned by the G.E., and got a little line representing all of the 265 or all of the instrumentalities it has used in working out this great scheme of profit, and I think that with what we have said in our briefs, if your Honor please, and what jumbled remarks that I have made here that the Court, if it can have the

time to study these briefs and study the law and study the amended complaint, that it is [84] one of the cleanest cut, clear, not only coming into that category where the Court will say, "Well, the doubt should be resolved in favor of the plaintiff," but it would be so clear that there just can't, it seems to me, be any misunderstanding about it being one of the cleanest and clear-cut joint ventures that has ever been presented to this Court.

And even the agricultural end of it was so thoroughly discussed and is a part of this, and the General Electric sent their man to Europe for the process of making fertilizer and sent for tons of dirt here and did a lot of work in connection with that, and went to the extent, if your Honor please, of paying the German company, Furbenk, some company like that, a half a million dollars for the right to use this in this particular project over there.

Now, then, they ought to be willing to make the Dam Brothers secure the balance of their lives, anyway, in doing just the common sense justice thing, and I believe, I have hopes—

The Court: I think I may as well recess here, Mr. Phipps. I am past my usual recess time. We usually recess at 11:00. I will take a ten-minute recess. This seems to be going on quite awhile.

Mr. Phipps: If your Honor pleases, I am just through and that would be better for your Honor. Just a word more. [85]

The very fact that they have gone ahead on the many things there, like the chemical processes and

things of that kind, and done some of the things, but they have done nothing for the Dam Brothers, and I was just going to conclude by saying, if your Honor please, that if your Honor would peruse these, I can't expect the Court to be Solomon and know everything, I am just assuming that it is necessary to read briefs and things of that kind in order to reach correct conclusions, and if that could be done and the case remain *status quo* until probably in the next term, that we might avoid the necessity of a long trial in this court if the Court was to sustain our complaint.

The Court: I think there has been some going outside the issues here on both sides. I have these motions now. I do intend to go into it and look at the briefs. However, if you have anything to say in response——

Mr. Brooke: I appreciate this is past the recess hour, but the Court is familiar with XI Securities and Exchange Commission Reports, page 1163—I believe you referred to them in your memorandum here—and in that it was held that the General Electric disposed of all of its investments in the Electric Bond and Share in 1925. And then your Honor has cited other cases here in your brief, 141 Federal (2d), 606, dissolving the American Power & Light, and refers to Electric Bond and Share and all of this setup, [86] and it is significant to me that the General Electric is not mentioned in any of those proceedings whatsoever, so that it is apparent that they have had nothing to do with this company since 1925.

And I think Mr. Phipps in his own argument stated that General Electric Company "neglected." They not only neglected, but they abandoned this thing years ago.

Now, then, we have a motion to make more definite and certain in about 25 different respects. This is a 40-page complaint, but I wonder if we could just let that pass over until you have studied on this matter?

The Court: If you wish to submit it, I will examine it in connection with the pleadings, because I will have to go pretty thoroughly into the file again. It has been a long time since I looked at that.

Mr. Phipps: That '25 date—just one word, your Honor—that '25 date when the General Electric absorbed the Electric Bond & Share, it just took it out of the heart of the General Electric and put it back in the veins. The General Electric, through its stockholders, controls it exactly the same as they did when they had the heart.

The Court: Court will recess now for ten [87] minutes.

#### Reporter's Certificate

United States of America,  
Eastern District of Washington—ss.

I, Donald B. Oden, do hereby certify: That at all times herein mentioned I was the duly appointed, qualified and acting official court reporter of the United States District Court for the Eastern District of Washington: that as such reporter I re-

ported in machine shorthand and transcribed the foregoing proceedings before the Honorable Sam M. Driver, United States District Judge, held at Spokane, Washington, on Wednesday, September 7, 1955; that the within and foregoing is a full, accurate and complete transcript of the proceedings had in the above-entitled cause on that date.

Dated this 21st day of February, 1957.

/s/ DONALD B. ODEN,  
Official Court Reporter.

[Endorsed]: Filed February 26, 1957. [88]

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Chambers of Sam M. Driver  
United States District Judge  
Spokane 10, Washington

September 14, 1955.

Phipps & Phipps,  
Attorneys for Plaintiffs,  
223 Rookery Building,  
Spokane 1, Washington;

Hamblen, Gilbert & Brooke,  
Attorneys for Defendant,  
General Electric Company,  
912 Paulsen Building,  
Spokane 1, Washington.

Gentlemen:

Re: Dam, et al. vs. General Electric Company, et al.

On September 7, I took under advisement motion of defendant General Electric Company to dismiss

the second amended complaint. One of the grounds of the motion is that, the joint venture agreement upon which plaintiffs rely was within the statute of frauds, the assumption being that the agreement was not in writing. Examination of the second amended complaint discloses that, paragraph XV, which covers the agreement, does not allege whether it was oral or in writing. I have considered it advisable, therefore, to first pass upon the defendant's motions to strike and for more definite statement, which also have been submitted. I have done so, and a copy of the resulting order will be mailed to you by the Clerk.

I have not reached any conclusion, or even finished my examination of the briefs on the motion to dismiss, and will not do so until the plaintiffs have complied with my order on the other motions. I assume that the motion of defendant General Electric to dismiss will be renewed after the more definite statement has been supplied.

I granted in part the motion to strike in order to keep the issues within manageable bounds, and to keep out potentially troublesome, immaterial factual allegations. I left standing enough of paragraph V of the second amended complaint to support the plaintiffs' position that Electric Bond & Share was a wholly owned, and completely dominated and controlled subsidiary of the defendant, General Electric. Whether or not the interrelationship of the two corporations and their corporate structures were such as to confuse and perpetrate

fraud and deceit on others dealing with Electric Bond & Share, seemed [34\*] to me to be wholly immaterial to the issues in this case. It affirmatively appears in the second amended complaint that plaintiffs were not so confused, deceived, or defrauded. Plaintiffs allege (see paragraph XIV, line 12, et seq., p. 9) that Mr. Charles A. Coffin, representing defendant General Electric, told them that the corporation wholly owned and completely dominated and controlled Electric Bond & Share.

I also regarded as immaterial the allegations that General Electric created and maintained monopolies in certain fields. Considering the extent and magnitude of General Electric's operations, that issue alone, if contested, could well take many months to try.

Yours very truly,

.....,

United States District Judge.

SMD/b

cc—Clerk, United States District Court,  
Eastern District of Washington.

Received September 14, 1955. [35]

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\*Page numbering appearing at foot of page of original Certified Transcript of Record.

[Title of District Court and Cause.]

## ORDER GRANTING IN PART MOTIONS TO STRIKE AND FOR MORE DEFINITE STATEMENT

This matter came on for hearing before the Court on September 7, 1955, on motions of the defendant, General Electric Company, directed to the plaintiffs' Second Amended Complaint, and the Court has heard the argument of counsel, considered the written briefs submitted, and is fully advised in the premises.

It Is Now, Therefore, Ordered, with reference to the motion of defendant General Electric Company for More Definite Statement that, paragraph VIII of said motion, directed to paragraph XV of the Second Amended Complaint, is hereby granted, and the plaintiffs are directed to state the date of the alleged joint venture agreement, and whether the same was oral or in writing, and, if in writing, to set forth a copy thereof, and to further state what officer or agent entered into said agreement for and on behalf of the defendant, General Electric Company. Otherwise, and as to all other paragraphs thereof, said motion is denied.

It Is Further Ordered that, the motion of defendant General Electric Company to Strike is granted to the extent that there is hereby stricken from the plaintiffs' Second Amended Complaint all that portion of paragraph V following the words "own uses and purposes," on line 29, page 3, to the end of said

paragraph, and said defendant's motion to strike is otherwise, [36] and in all other particulars, denied.

It Is Further Ordered that, to relieve plaintiffs of the burden of rewriting their Second Amended Complaint, which consists of twenty-two typed pages, the plaintiffs may, if they desire, comply with this order by having the Clerk of this Court delete the portion of paragraph V hereby ordered stricken, by drawing a line through the same, without rendering it illegible; and by interlineation of paragraph XV of the Second Amended Complaint to conform to this order; or, by serving and filing a supplemental statement of paragraph XV in the nature of a bill of particulars, setting forth the more definite statements directed to be made by this order.

Dated this 14th day of September, 1955.

/s/ SAM M. DRIVER,

United States District Judge.

[Endorsed]: Filed September 14, 1955. [37]

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[Title of District Court and Cause.]

CONSENT TO INSERTING AND DELETING  
CERTAIN MATTER IN PLAINTIFFS'  
SECOND AMENDED COMPLAINT

To: Hon. Stanley Taylor, Clerk, United States Dis-  
trict Court, Eastern District of Washington.

In conformity with the Court's Order made in  
the above-entitled case on September 14, 1955, the

names of the Officers and Agents of the defendants acting in the oral Joint Venture Agreement made between said parties, in the year A.D., 1913, at New York City, New York, were Charles A. Coffin, Sidney Z. Mitchell with Henry Pierce coming in later to aid in the unfolding of said Agreement, and the Clerk of the above-entitled Court is hereby authorized to either file or insert these names as ordered by the Court to be named, and to delete that part of Paragraph V of said plaintiffs' Second Amended Complaint in conformity with the Order of the Court. Said insertions and deletions to be added to said plaintiffs' Second Amended Complaint in the way and in the places determined by the Clerk to be most convenient.

Respectfully submitted,

PHIPPS & PHIPPS,

/s/ HARVE H. PHIPPS.

[Endorsed]: Filed September 28, 1955. [38]

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[Title of District Court and Cause.]

CONSENT TO INSERTING AND DELETING  
CERTAIN MATTER IN PLAINTIFFS'  
SECOND AMENDED COMPLAINT

To: Hon. Stanley Taylor, Clerk, United States District Court, Eastern District of Washington.

In conformity with the Court's Order made in the above-entitled case on September 14, 1955, please

insert the following amendments to our Second Amended Complaint:

- (a) To delete that part of Paragraph V of said Second Amended Complaint, striking the comma after the words "uses and purposes" and insert in lieu thereof, a period, and delete the balance of said Paragraph V and for the purpose of the record, the plaintiffs reserve their objections to such deletions.
- (b) As to the date of said Joint Venture Agreement, as set forth in plaintiffs' Second Amended Complaint, strike the comma after the second repetition of "New York" in Paragraph XIII of said Second Amended Complaint, and then insert the following—A.D., 1913.
- (c) In Paragraph XV of plaintiffs' Second Amended Complaint, at the beginning of Line 4, strike the letter "a" and insert the following—"an oral."
- (d) In Paragraph XV of said plaintiffs' Second Amended Complaint, after the comma, following the word "hand" in Line 7 and before the word "under" insert the following—A.D., 1913. [39]

The officers and agents of the defendants acting in the oral Joint Venture Agreement made between said parties in the year A.D., 1913, were Charles A. Coffin, Sidney Z. Mitchell, with Henry Pierce coming in later to aid in the unfolding of said Agreement.

I trust that you will find these amendments to be sufficient to comply with said Order, but if any additional insertions are necessary in your judgment to effectuate the purpose of the Order, you are fully authorized to make same.

Respectfully submitted,

PHIPPS & PHIPPS,

/s/ HARVE H. PHIPPS.

Service of copy acknowledged.

[Endorsed]: Filed September 30, 1955. [40]

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[Title of District Court and Cause.]

### MOTION TO DISMISS

Comes now the defendant, General Electric Company, and moves the court with reference to the plaintiffs' Second Amended Complaint, as follows:

#### I.

To dismiss the action as to the General Electric Company for the reason that said Second Amended Complaint fails to state a claim against the defendant upon which relief can be granted.

#### II.

To dismiss the action on the ground that all the defendants named above are indispensable parties to said action and the defendants, American Power & Light Company and Electric Bond & Share Com-

pany, are not subject to service of process in the Eastern District of Washington or in the State of Washington, and the attempted service of process upon said defendants has been quashed pursuant to orders heretofore entered in the above-entitled cause.

### III.

To dismiss the action on the ground that the claims asserted therein are void under the statute of frauds. [41]

### IV.

To dismiss the action on the ground that the claims asserted therein are barred by the statute of limitations.

### V.

To dismiss the action on the ground that the claims asserted therein are barred by reason of laches on the part of the plaintiffs.

/s/ PHILIP S. BROOKE,

/s/ L. R. HAMBLEN,

HAMBLEN, GILBERT &  
BROOKE,

Attorneys for Defendant  
General Electric Company.

Service of copy acknowledged.

[Endorsed]: Filed October 7, 1955. [42]

[Title of District Court and Cause.]

AFFIDAVITS SUBMITTED BY GENERAL  
ELECTRIC COMPANY IN SUPPORT OF  
ITS MOTION FOR SUMMARY JUDG-  
MENT

The defendant, General Electric Company, submits the following Affidavits in support of its Motion for summary judgment:

Affidavit of Ray H. Luebbe;

Affidavit of B. H. Kizer;

Affidavit of Philip S. Brooke.

/s/ PHILIP S. BROOKE,

/s/ L. R. HAMBLEN,

HAMBLEN, GILBERT &  
BROOKE,

Attorneys for Defendant  
General Electric Company.

Service of the Within Affidavits Is Hereby Admitted this 13th Day of October, 1955.

/s/ HARVE H. PHIPPS,

Attorney for Plaintiff. [43]

## Affidavit

Ray H. Luebbe, being duly sworn, deposes and says:

I am a vice president and am secretary and general counsel of General Electric Company. I have my office at 570 Lexington Avenue, New York 22, New York.

After the commencement of the action, Dam Brothers vs. General Electric Company, et al., in 1952, (District Court of the United States for the Eastern District of Washington, Northern Division) a search of the General Electric Company record files was conducted. These record files of the General Electric Company are maintained in or near Schenectady, New York. I have been advised that this search failed to reveal any correspondence or other documents concerning the existence of the alleged joint venture between the Dam Brothers and the General Electric Company or its alleged agents.

Mr. Charles A. Coffin was the first president of the General Electric Company. He died on July 14, 1926.

Mr. Sidney Z. Mitchell was formerly president of the Electric Bond & Share Company. He died on February 17, 1944.

/s/ RAY H. LUEBBE.

Sworn to before me this 6th day of October, 1955.

[Seal]      /s/ MAE M. HAYWARD,  
                    Notary Public.

Commission expires March 30, 1957. [44]

State of Washington,  
County of Spokane—ss.

B. H. Kizer, being first duly sworn, on oath deposes and says:

That he is a member of the firm of Graves, Kizer, Greenough and Gaiser, formerly Graves, Kizer & Graves, and has been engaged in the practice of law in the City of Spokane, Washington, since 1902; that affiant's firm represented Violetta E. Pierce in those certain divorce actions entitled Henry J. Pierce vs. Violetta E. Pierce, reported in 68 Washington 415, 107 Washington 125, and 120 Washington 411; that as disclosed by the reports of said actions, Henry J. Pierce moved from New York City to Spokane, Washington, in 1909, and retained his residence in the State of Washington until subsequent to 1922; that by reason of the prolonged litigation between Henry J. Pierce and Violetta E. Pierce, affiant became very well acquainted with the said Henry J. Pierce.

That the said Henry J. Pierce who was affiliated with Electric Bond & Share Company has been dead for over twenty (20) years.

/s/ B. H. KIZER.

Subscribed and sworn to before me on this 7th day of October, 1955.

[Seal] /s/ PHILIP S. BROOKE,  
Notary Public in and for Washington, Residing at  
Spokane. [45]

State of Washington,  
County of Spokane—ss.

Philip S. Brooke, being first duly sworn, on oath deposes and says:

That he is one of the attorneys for General Electric Company, one of the defendants in the foregoing action; that diligent search and inquiry has failed to disclose that "Priest Rapids Power Company," "Terminal Townsite Company" and "Tufa Natural Cement Company" or any of them, were ever incorporated pursuant to the Joint Venture Agreement alleged in the Second Amended Complaint as amended, to have been entered into in the year 1913; that as disclosed by the Certificate of Earl Coe, Secretary of State of the State of Washington, marked Exhibit "A" attached hereto and made a part hereof, none of said corporations were organized in the State of Washington or qualified to do business in said state at any time since prior to the date of the alleged Joint Venture Agreement.

/s/ PHILIP S. BROOKE.

Subscribed and sworn to before me on this 13th day of October, 1955.

[Seal] /s/ ROBERT E. BROOKE,  
Notary Public in and for Washington, Residing at  
Spokane. [46]

## EXHIBIT A

Certificate No. 31282

United States of America  
State of Washington  
Department of State

To All to Whom These Presents Shall Come:

I, Earl Coe, Secretary of State of the State of Washington and custodian of the Seal of said State, do hereby certify that the corporate records of this office show "Priest Rapids Power Company"; "Terminal Townsite Company" and "Tufa Natural Cement Company" have not qualified to do business in this state either as foreign or domestic corporations at any time subsequent to the year 1912.

In Testimony Whereof, I have hereunto set my hand and affixed hereto the Seal of the State of Washington. Done at the Capitol, at Olympia, this 11th day of October, A.D., 1955.

[Seal] /s/ EARL COE,

Secretary of State;

By /s/ RAY J. YEOMAN,

Assistant Secretary of State.

[Endorsed]: Filed October 14, 1955. [47]

[Title of District Court and Cause.]

### AFFIDAVIT OF MILTON E. DAM

State of California,  
County of Sacramento—ss.

Milton E. Dam, being first duly sworn, deposes and says:

That he is one of the plaintiffs in the above-entitled action.

That the plaintiffs believe in view of the extraordinary circumstances and conditions which caused and prompted the General Electric Company to desire and bring about the Joint Adventure Agreement between General Electric and Dam Brothers, justify and make necessary an explanatory and clarification statement concerning the contractual arrangements.

That the Joint Adventure Agreement between General Electric and the Dam Brothers was "Oral."

That the absence of a written agreement was absorbed by the acts, performances and accomplishments of the purpose of the General Electric plans—to operate without a written agreement was not the choice of Dam Brothers—they, the General Electric wanted it that way—until they could gain control of the Priest Rapids site and obtain workable federal water power legislation.

That the records will show why there was no written agreement, and hush hush and secrecy was demanded of Dam Brothers. [48]

That the names of the General Electric Company officials and agents were:

A. Mr. Charles A. Coffin, chairman of the board, founder and builder of the company, and one of the first developers of electric power;

B. Mr. Edwin W. Rice, Jr., president; associate and assistant to Mr. Coffin—*inventor and a genius in the electrical field*;

C. Mr. Sidney Z. Mitchell, originally with General Electric following college—called from the field by Mr. Coffin to help organize the Electric Bond & Share Company, made vice president, with an officer of General Electric as president of Electric Bond—but was president of same at the time of the New York meeting, 1913.

That the Dam Brothers knew little at that time regarding the Electric Bond but did know of and had great respect for the General Electric and its products and therefore went into the Joint Adventure meetings with faith and confidence in that great company and the individuals representing General Electric Company.

That the records will show it was wise and logical for General Electric to offer a concrete transaction to the Dam Brothers, which resulted in the Joint Adventure Agreement General Electric desired and made.

That it is not possible to name or designate a given day or date for the said Joint Adventure

Agreement between General Electric and Dam Brothers, for the reason that the meeting and conferences in New York covered a period of many days during April and May, 1913.

That the agreement could not be classed with the usual business agreement or contract, as the conferences were in the nature of a continuous and connecting presentation—unfolding gigantic plans of General Electric, with the purpose of having Dam Brothers join in and help as principals.

That the plans could not go forward without the association of Dam Brothers, their own Priest Rapids development plans, their interests, position and influence in state and federal officials.

That the long conferences with the review of very secret plans, how same should be undertaken with regard to federal legislation, acquisition of needed properties and minerals, discussing the problems and development features, arriving at decisions as the matters were worked out, from day to day over the long period.

That Mr. Coffin was the creator of and the forceful prime mover of the gigantic plan to benefit General Electric and the country—that the plans were practical dreams of Mr. Coffin, to lighten the burden of mankind, as well as create wealth—these plans came true in every phase with enormous benefit to General Electric, and its subsidiaries.

That it must be understood that Mr. Coffin was deeply interested in and actually developed and

built power plants and sold the electricity before he became the big manufacturer of electrical products by his new venture of organizing General Electric; never did confine his ability and efforts to solely manufacture; always had the ambition to bring about more and cheaper electric power, leaving an unequaled record of accomplishing just that. [49]

That it would be difficult to understand or make a true and factual appraisal of the whole General Electric-Dam Brothers affair and agreement, with all the normal questions and legal points, without a brief review of the life of Mr. Coffin, his plans for General Electric, and the work and performances of the men selected by Mr. Coffin to undertake these plans, with some quotations from prominent and authoritative publications.

“Science” of December 8, 1922, “The Charles A. Coffin Foundation.”

“On May 16, 1922, Mr. Charles A. Coffin in his seventy-eighth year, retired from the active leadership of the General Electric Company. Mr. Coffin has been identified with the development of the electrical industry since 1882. He was founder and creator of the General Electric Company of which he has been the inspiration and leader for 30 years.”

“The National Encyclopedia of American Biography,” Vol. XX.

“For nearly twenty years was engaged in Shoe manufacturing and in financing. \* \* \* Mr. Coffin

did more to create and stabilize the electrical industry than any other man or group of men. His encouragement of invention along useful lines, his financial talents, his tireless energy and his courage in introducing new apparatus made his work supreme in the field to which he devoted his life."

"Dictionary of American Biography Electrical Record," Aug., 1926.

"He interested himself keenly in the work of such men as Elihu Thompson, Edwin J. Houston, and Edwin W. Rice, Jr. In 1892 the Thompson-Houston Company was consolidated with the Edison General Electric Company, in which all the activities and interests of Edison's incandescent lamp development had been merged. Coffin was elected president of the new firm, which took the name of the General Electric Company, and he held that office until 1913. From 1913 to 1922 he was chairman of the board of directors.

"The growth of the General Electric Company under Coffin's leadership was phenomenal. Coffin supported the work of the Company's engineers in developing the Curtis Steam Turbine which revolutionized the primary power sources in Electric Light and Power stations."

"Engineering News Record," July 22, 29, 1926;  
Editorial.

"An Empire Builder" \* \* \* Charles A. Coffin, builder of General Electric Company, will long live

as the organizing genius, who shaped one of greatest structures of manufacturing activity in the world's history. Moreover, he was wise enough to choose as his own successors, men who would carry his own work with equal breadth of vision and with equal understanding of the basic dependence of modern industry upon engineering and scientific progress."

"*Forbes Financial Magazine,*" May 15, 1926.

"Mr. Coffin, founder and upbuilder of the General Electric Company, is the recognized dean of the whole electrical industry of the United States—in fact, of the world.

"The growth of electricity and America's world leadership in electricity are due more to Coffin's vision, industry and daring than to any other man living. [50]

"In discussing \* \* \* in a note to the Editor of '*Forbes*,' Mr. Coffin makes one of the few long statements regarding electricity, its contribution to the world, distribution, enormous possibilities, electric public utility enterprises, industrial power, transportation fields. Mr. Coffin said 'Electricity took over a most important task when it set itself to providing a better and cheaper means of manufacturing it.' "

That the General Electric with its subsidiary, International General Electric in London, and its interest in the German General Electric concern, Mr. Coffin was in position to learn of new major discoveries and inventions in the Electro-Metallurgical

and Electro-Chemical field in Europe—large users of electric power—none of which processes and plants had been built or in use in this country, but which were vital in peace and in war.

That one of the subjects considered most important as well as serious, yet very confidential, discussed during the Joint Adventure conferences in New York, was the favorable prospect of bringing some of the foreign processes and discoveries to Priest Rapids, not only to use the power to be made there, but for the good of the country, the farm and industry, to make available these imported products for peace time benefit and for the protection of our country in time of war.

That Mr. Coffin had formulated a practical plan for bringing about the development of water powers, and considered the Priest Rapids site on the Columbia River, State of Washington, as the “apple of his eye”—being then the most attractive for producing large blocks of low-cost power.

That the federal laws of 1906 and 1910 had caused stagnation in the development of water powers, and General Electric wanted to see the laws changed to permit the development at Priest Rapids.

That General Electric found itself in an unfavorable position on account of being called the “Power Trust” and the General Electric felt that no federal legislation could ever be obtained if the Company or its officers or interests were identified with the legislative work, or were behind such changes in

the laws. The records will show the extent of this unfavorable public and government feeling.

That the Dam Brothers with their strong position at Priest Rapids, their plans, position with the public and government officials, would give a favorable impression for the proposed federal legislation to permit a dam to be built at Priest Rapids. That the users of the power to be located at Priest Rapids would require important raw materials and minerals and that General Electric would have to have same investigated and located and in some instances even acquire to protect the sale of the power. That the Dam Brothers with their laboratory and own investigation could continue in the same way and not excite public interest.

That the Dam Brothers did visit the Capitol, Washington, D.C., and conferred with the leaders of both parties in Congress, the Secretary of Interior, and reported back to New York, with the favorable reception and promise of favorable introduction and action on a bill to permit the development of the Priest Rapids project—the move, which ended in finally obtaining the law that created the Federal Power Commission—that following its enactment, two billions of dollars of water power permits were filed, during the first year. The records will show the enormous benefit to the General Electric and its subsidiaries and interests. [51]

That unlike today, Mr. Coffin and Mr. Mitchell, both, were the organizers of the concerns they

headed back then, built them up and were personally interested in them, while the present officials are high executive employees.

That at the time of the General Electric-Dam Brothers Joint Adventure Agreement meetings, Mr. Coffin was 69 years old, and why he was anxious to see the federal legislation obtained, and the government license to build the dam at Priest Rapids, as an example and objective lesson—to be the “Niagara of the West”—an all electric city—electric power, industry, irrigation and agriculture—using the natural resources of the Northwest.

That Mr. Coffin was keenly disappointed that the federal water power legislation was not enacted until 1920, but realized that his practical dream and plans for the development of water power was now unfolding and possible of full expectations, with the broad benefit to the General Electric Company, in creating demand for heavy electric equipment, low-cost power for new and soon to be perfected various electrical appliances, and most of all for the stability of electric utility securities, as needed for financing.

That the retirement of Mr. Coffin on May 16, 1922, brought the first known public statement, which is historic and revealing now.

(President Woodrow Wilson signed the Water Power Bill, June, 1920.)

The statement by Mr. Coffin June 22, 1922:—“‘Electric Age Just Begun,’ Says Pioneer in Industry, ‘and Future Is Enormous.’”

“ ‘Electricity has brought advantages to the country village and farm—well, watch what electricity is going to do next.

“ ‘Electricity,’ Mr. Coffin said, ‘is not only the cleanest and most efficient servant of mankind, it is the cheapest’ \* \* \* ‘its efficiency is being constantly increased.

“ ‘Cloth will more and more be manufactured where the cotton is grown. Soon we will be sending the power across the country.

“ ‘The outside world “closer.”’ The radio has burst on us, motion pictures may be broadcast \* \* \* in your own home, in Maine or Washington (Mr. Coffin was born in Maine and Priest Rapids in the State of Washington) \* \* \* This Is Dreaming, of Course, for No One Can Predict With Any Accuracy Concerning Such Matters. Of one thing I Am Certain, That Is That We Are Just in the Beginning of the Electric Age.

“Mr. Coffin said in the early days, ‘Electricity in those days was a thing you read about in the papers; promoting electricity was much more hazardous from the business standpoint than manufacturing shoes; the main thing was to get electricity to the people. We believed in it with a Holy Faith, if we hadn’t we never should have dared the things we did.

“ ‘We laid out our plans to establish central power plants in every place we could. We planted

plants everywhere. The plants like those of the New York Edison and the Philadelphia Electric are the outgrowth of the central power stations we established then.’’

(The Editor stated: “Mr. Coffin has received honors and decorations from governments throughout the world, but he wears them lightly. His picture is scarcely known to the newspaper reading public. He is modest in the [52] extreme.”)

That the answers of the particular questions and points before the plaintiffs now cannot be found in the law books, but only from the statements of Dam Brothers, based upon the truth and facts pertaining to those points, as named in Sheets 1 and 2.

The whole General Electric-Dam Brothers affair was built upon Mr. Charles A. Coffin’s plans for benefiting General Electric, and following his life’s ambition to bring about development of water power, with the first development at Priest Rapids, and the expansion of uses for electricity in the plants of industry, the farm and home. The continuous and connecting acts, performances and vast expenditures made in connection with the Joint Adventure Agreement following its creation in 1913, as shown by the vast amount of evidence, represented Mr. Coffin’s plans in action.

That the Dam Brothers as principals acted under a well defined understanding and carried out and carried thru effectively and faithfully their part of

the General Electric-Dam Brothers contractual arrangements, completely and to the letter. The Joint Adventure arrangement was broadened after the original date because of the conditions affecting the plans, whereby Dam Brothers were needed and performed additional important functions.

That during the Joint Adventure conferences, Dam Brothers were assured that the plans desired by and backed by the General Electric, would be carried; that with the start of the activities following the conferences, the Dam Brothers were to work with and operate under Mr. Mitchell, president of Electric Bond, which organization had the legal structure and engineering equipment; that the permanent organizations for the Power Company, the Terminal Townsite Company, for vital mining and minerals, would all be formed after the federal water power legislation had been obtained.

That as late as 8 years after the Joint Adventure conferences, following the enactment of the federal legislation, one of the main achievements accomplished, and Mr. Coffin was ready to retire at the age of 79, he still had to be consulted by Mr. Mitchell, and obtain Mr. Coffin's approval.

That of the important factors in Dam Brothers decision to join General Electric during the New York meeting, was the direct influence upon them of Mr. James Marwick, head of the International Financial Accounting and Consulting firm of Marwick, Mitchell, Peat & Company, 79 Wall Street,

New York, London and Paris—a personal friend of Mr. Coffin, and knew of the European processes which Mr. Coffin in his vision and ambition wished to bring to Priest Rapids—General Electric was a client of Mr. Marwick's firm, and has been to this date continuously.

That the questions dwelt upon continually by the defense, portraying ignorance of General Electric and officials identification, is ridiculous. The foregoing statements pertain to vital facts and subject matter which have been attacked in legal form, but, which can only be met and covered by the plaintiffs' Affidavit; and is only a brief outline of some facts, events, acts and performances.

/s/ MILTON E. DAM.

Subscribed and Sworn to before me this 27th day of October, 1955.

[Seal]      /s/ MOLLIE L. SALK,  
                    Notary Public in and for the  
                    State of California.

Service of copy acknowledged.

[Endorsed]: Received and Filed November 2, 1955. [53]

[Title of District Court and Cause.]

AFFIDAVIT OF JOHN W. BREMER

Defendant General Electric Company submits the attached Affidavit of John W. Bremer in support of its Motion for Summary Judgment.

/s/ PHILIP S. BROOKE,

/s/ L. R. HAMBLEN,

HAMBLEN, GILBERT &  
BROOKE,

Attorneys for Defendant Gen-  
eral Electric Company. [54]

Affidavit

State of New York,  
County of New York—ss.

I, John W. Bremer, being duly sworn, depose and say that I am assistant secretary of the General Electric Company; that I have examined the official records of said General Electric Company and that I find from such records that Edwin Wilbur Rice, Jr. was president of General Electric Company from 1913 to 1922 and died on November 25, 1935.

/s/ JOHN W. BREMER.

Signed and sworn to before me this 7th day of November, 1955.

[Seal]      /s/ MAE M. HAYWARD,  
                    Notary Public.

Commission expires March 30, 1957.

Service of copy acknowledged.

[Endorsed]: Filed November 10, 1955. [55]

Chambers of Sam M. Driver  
United States District Judge  
Spokane 10, Washington

January 3, 1956.

Phipps & Phipps,  
Attorneys for Plaintiffs,  
223 Rookery Building,  
Spokane 1, Washington;  
  
Hamblen, Gilbert & Brooke,  
Attorneys for Defendant,  
General Electric Co.,  
912 Paulsen Building,  
Spokane 1, Washington.

Gentlemen:

Re: Dam, et al. vs. General Electric Co.,  
et al.—No. 1036

When I examined the original file in the above case recently, in my consideration of defendant's motion to dismiss, for the first time the letter of Phipps & Phipps, dated November 2, 1955, which had been attached to the inside of the Clerk's file cover, came to my attention. In that letter, plaintiffs' attorneys call attention to the affidavits filed by defendant's counsel, question their relevancy, and express the view that the Court should regard the motion strictly as a motion to dismiss and, consequently, consider only the allegations of the second amended complaint. I had assumed that these affidavits were submitted for the Court's consideration under the

provisions of Civil Rule 12 (b) quoted by Mr. Phipps on the first page of his letter. The provision is that, if, on motion to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to, and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material matters pertinent to such a motion by Rule 56. Rule 56 (b) authorizes a party against whom a claim is asserted to move at any time with, or without supporting affidavits, for a summary judgment in his favor. Rule 56 (c) provides that the motion shall be served at least ten days before the time fixed for the hearing, and that the adverse party, prior to the hearing, may serve opposing affidavits.

I propose to treat the motion to dismiss as a motion for summary judgment but, obviously, I should give the plaintiffs an opportunity to submit affidavits or other material matters if they care to do so. I shall, in any event, consider the affidavit [56] of plaintiff Milton E. Dam, dated October 27, 1955, which appears in the file, so far as its contents are pertinent to any issues raised by the motion. The plaintiffs will have until January 20, 1956, in which to file any additional affidavits or other matters which they wish to submit for the Court's consideration. Copies of any such affidavits or matters should be served upon opposing counsel prior to filing, and since it would not be feasible for me to undertake

to reach a decision before I return from Alaska in February, counsel on both sides will have until February 10, 1956, in which to file with the Clerk any supplemental brief or memorandum of additional authorities which they wish to present. I shall, of course, consider all briefs, memoranda, etc., heretofore submitted by counsel on the motion to dismiss.

I think we should bear in mind that it is not at all necessary for the plaintiffs to supplement their second amended complaint by affidavits setting forth further elaborating details. On motion for summary judgment, as well as on motion to dismiss, the Court will take the allegations of the pleading as true, and judgment can be awarded to the defendant only in case, as a matter of law, it is entitled to judgment on the undisputed facts. Affidavits submitted in support of the motion to dismiss will also be taken as true, insofar as they are not controverted or disputed by counter affidavits.

Yours sincerely,

.....,  
United States District Judge.

SMD/b

cc—Clerk, U.S. Dist. Court.

Received January 4, 1956. [57]

[Title of District Court and Cause.]

### AFFIDAVIT OF MILTON E. DAM

State of California,  
County of Sacramento—ss.

Milton E. Dam, being first duly sworn, deposes and says:

That he is one of the plaintiffs in the above-entitled action.

That reference is made to the Further Additional Memorandum of General Electric Company Re: Motion for Summary Judgment, dated February 23, 1956, just received and noted by the undersigned.

That the General Electric by its continued attitude of ignoring and recognizing the meaning of the facts, conditions and circumstances as covered by the documents already filed in connection with this affair, with added self manufactured deductions which continue to disagree with the true facts, demand further statements of facts.

That the stress repeatedly placed on the conjecture and surmise that the plaintiffs were lax and late in bringing this action; the neglect to learn what was going on; the attempt to change the facts regarding the General Electric-Dam Brothers Joint Adventure affair, particularly as to the incorporations of the power company, the terminal and townsite company, and the other several factual

points which they try to underwrite the law involved.

That the above together with the continued inference for lack of any records, etc., the General Electric forces the plaintiffs to include in this statement references which relate to the Joint Adventure affair, its history and this case, which references it is believed will not be welcomed by General Electric, yet, in addition to close relation to the affair, is a dark chapter in the History of the General Electric, its interests and its high officials then.

That the undersigned has had continuous knowledge and relations with every development and event that affected and related to the General Electric-Dam Brothers Joint Adventure, for all the period referred to by the General Electric Memorandums, also, knew and was taken into private confidence regarding private matters of General Electric because of the bearing and relationship of this [58] affair.

That before going into the spectacular reference regarding General Electric in trouble which has a direct relation to and bearing upon the Joint Adventure affair together with meeting many of the assumptions, it is fitting to make an over all statement and denial and correction.

That the plaintiffs are now relying upon "an Oral" agreement. The conjecture is far from the truth and facts. The real circumstances and conditions which involved upwards of Ten Millions of

Dollars to accomplish the plans and purposes of the General Electric hidden under the Joint Adventure affair, created a structure from the Oral Agreement, with a mass of evidence, year by year.

That in connection with the General Electric plans and objective, there were performed and completed such items of the agreement as acquiring complete water power site lands and property; water and rail terminal lands, townsite and industrial site lands; mineral properties needed for construction purposes and power users, the cost of the other activities such as investigations, foreign processes, engineering, and finally Federal water power legislation.

That the plaintiffs were not only informed of every act and performance, but participated in many business transactions. That the statement plaintiffs sat by all this time without commencing action is ridiculous, and misleading. There was no laxity.

That the full period of time mentioned by the General Electric Memorandum can be accounted for without any excuses. The World War I contributed some to the delay in obtaining the favorable Federal Water Power legislation (enacted June, 1920). The writing of the Rules by the Government took one year following the enactment. The Preliminary Permit was not issued until March 3, 1921.

The General Electric did not want the power company or any of public creating acts such as incor-

porating, until the License was obtained for the same secret reason as plans had been carried on under the name of a dummy and the true identity hidden.

That the following period was consumed by continuous and connecting acts and performances, which with large expenditures were accepted by plaintiffs as good faith of General Electric, including diamond drilling, engineering plans, foreign process for use at Priest Rapids.

The unexpected protests from fishing industry, years delay in having the Federal License granted, the renewed public attack of the Power Trust leveled at General Electric, the tremendous demand and launching of new power project, mergers, acquisitions; with the attack on General Electric breaking into a Government investigation; the sudden passing of Mr. Charles A. Coffin, followed just a year later, 1927, with the sudden passing also of Mr. Anson W. Burchard, president of International General Electric, who had been active in certain Joint Adventure activities as the evidence will fully sustain.

Then being overtaken by the World Wide Crash of October, 1929; the depression following; the plaintiffs were in New York during this period; then followed the Government major move to develop large hydroelectric projects, with private Utility interests in the West facing stagnation of their own plans; one of the high officials of our own Home Private Utility stated the starting of Cabinit

Gorge (about 1950-1) was the first for them since 1929.

That the non-starting of the building of the dam at Priest [59] Rapids, the filing of this action in 1952, the matter of Laches, the attempt to now apply other points to delay and defeat justice, just cannot be compared to any other case or agreement, there is no other comparative; the gigantic affair requires the full and connecting story and evidence from start to time of filing 1952.

That the General Electric was the only other party to the General Electric-Dam Brothers Joint Adventure Agreement and affair; that the claim of prejudice by the loss of time and the passing of three individuals, the presence of same would have eliminated any such legal action, the complete mass of connecting evidence would meet and dissolve oral statements, and are sufficient for the case.

That the General Electric should refer to its files on the Government investigation, disclosures and resulting affect on the Company and its relations to and bearing on the Joint Adventure, cracking open before the Federal License was obtained for the Priest Rapids dam; the continuing of the government investigation over many years, having much to do with the interruption of the starting of the construction of the dam at Priest Rapids.

That the plaintiffs were aware of most private details of the General Electric trouble, etc., and while it was no fault of theirs and they suffered from the

affair, their long associationship and work with the General Electric plans, and their makeup, reflected nothing but loyalty and even moral support—for such gigantic affair and attitude, can the General Electric now assert with respect such statements that would unfairly give other meanings.

That the conditions, circumstances and records will show the Joint Adventure main physical feature, Priest Rapids project, with the application of the law as covered by the Counsel under the Joint Adventure and also the statute references, together with the fact the undersigned has been in continuous attention with the events up to the filing, the project was just as attractive and its possibilities, up to the time plaintiffs realized action needed.

That the relation between Dam Brothers and General Electric was more than the business; Mr. Edwin W. Rice, Jr., and the mother of the plaintiffs were born in close neighboring small mid-western towns—and his mother was born in a small town further West where plaintiffs had blood relative lived and often visited.

That the Complaint and the Documents already filed contain honest to God facts and truth about this affair, and the mass of relating material has only been picked at here and there, and in respect for the request of the Court in letter of January 3, 1956, to not be elaborating in details, etc.

/s/ MILTON E. DAM.

Subscribed and sworn to before me this 9th day of March, 1956.

[Seal] /s/ JOHN M. BRUNTON,  
Notary Public in and for the State of California,  
Residing at Sacramento.

My Commission expires Nov. 29, 1957.

Receipt of Copy acknowledged.

[Endorsed]: Filed March 12, 1956. [60]

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Chambers of  
Sam M. Driver  
United States District Judge  
Spokane 10, Washington

Walla Walla

March Twentieth, 1956.

Phipps & Phipps,  
Attorneys for Plaintiffs,  
223 Rookery Building,  
Spokane 1, Washington;

Hamblen, Gilbert & Brooke,  
Attorneys for Defendant General Electric Co.,  
912 Paulsen Building,  
Spokane 1, Washington.

Gentlemen:

Re: Dam Brothers v. General Electric Co.,  
et al.—No. 1036.

On March 12, 1956, plaintiffs' attorneys filed with the Clerk an additional affidavit of Milton E. Dam,

in the above case. Defendant's attorneys have requested that, if the affidavit is to be considered by the court they be granted an additional two weeks in which to respond.

In my letter to the attorneys of January 3, 1956, I stated that I proposed to treat the motion to dismiss as a motion for summary judgment, as provided in the Federal Rules of Civil Procedure, but I felt that the plaintiff should have an opportunity to submit affidavits or other material pertinent to the issues raised by the motion, and I gave the plaintiffs until January 20, to do so. I also allowed the attorneys for both parties until February 10, in which to file with the Clerk any supplemental brief or memorandum of additional authorities they wished to submit. I do not regard the dates mentioned as absolute deadlines, but an affidavit filed more than seven weeks after the specified time limit is not, I feel, timely.

Moreover, the document apparently was intended to be an answering argument directed to "the Further Additional Memorandum of General Electric Company Re: Motion for Summary Judgment, dated February 23, 1956." A litigant may not properly interpose a written argument or brief when he is adequately represented by counsel.

The affidavit contains little, if any, direct factual statement to which the affiant could testify if he were a witness in the case. For the reasons stated, it will not be considered in ruling upon defendant's motion. [61]

Yours very truly,

.....,  
United States District Judge.

SMD/b

cc: Clerk, U. S. District Court.

[Endorsed]: Filed March 20, 1956. [62]

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[Title of District Court and Cause.]

**ORDER DENYING MOTION TO DISMISS OF  
DEFENDANT GENERAL ELECTRIC CO.**

The defendant General Electric Company has filed herein a motion to dismiss the plaintiff's second amended complaint, which motion is based upon five separately stated grounds, the third, fourth and fifth of which are, respectively, as follows:

**III.**

To dismiss the action on the ground that the claims asserted therein are void under the statute of frauds;

**IV.**

To dismiss the action on the ground that the claims asserted therein are barred by the statute of limitations;

**V.**

To dismiss the action on the ground that the claims asserted therein are barred by reason of laches on the part of the plaintiffs.

The motion to dismiss is supported by affidavits filed on behalf of the moving defendant, and is opposed by counter-affidavits filed on behalf of the plaintiffs. It was understood that the court would treat the motion as a motion for summary judgment under the provision of Rule 12 (b) of the Rules of Civil Procedure. But Rule 8 (c) of the Civil Rules requires [63] that, in responding to a preceding pleading, a party shall set forth affirmatively, among other enumerated defenses, laches, statute of frauds, and statute of limitations; and the court has come to the conclusion that it would be inadvisable to pass upon defendant's motion as one for summary judgment before the said defendant has answered and pleaded laches, statute of frauds, and statute of limitations as affirmative defenses. Therefore, without passing upon the merits of the issues raised by defendant's motion to dismiss, it is now

Ordered that the motion of defendant General Electric Company to dismiss plaintiffs' second amended complaint is hereby denied, and the said defendant is allowed twenty days from and after the date of this order in which to answer plaintiffs' second amended complaint.

Dated this 29th day of May, 1956.

/s/ SAM M. DRIVER,

United States District Judge.

[Endorsed]: Filed May 29, 1956. [64]

Chambers of  
Sam M. Driver  
United States District Judge  
Spokane 10, Washington

May Twenty-Ninth, 1956.

Hamblen, Gilbert & Brooke,  
Attorneys for Defendant,  
General Electric Company,  
912 Paulsen Building,  
Spokane 1, Washington.

Phipps & Phipps,  
Attorneys for Plaintiffs,  
223 Rookery Building,  
Spokane 1, Washington.

Gentlemen:

Re: Dam Brothers vs. General Electric Co.,  
et al.—No. 1036.

As I have heretofore indicated, it was my purpose to pass upon motion to dismiss of defendant General Electric Company as a motion for summary judgment under the provisions of Rule 12 (b) of the Rules of Civil Procedure. However, upon more critical examination of that particular section, I note its provision that, motion to dismiss may be treated as one for summary judgment, is limited to defense (6), namely, that the complaint does not state a claim on which relief can be granted. Defendant's motion to dismiss is based not only upon defense (6) but also asserts the defenses of laches,

statute of frauds, and statute of limitations. Rule 8 (c) specifically provides that the three defenses last named must be affirmatively pleaded, and it seems to me quite doubtful at least that such defenses could properly be passed upon by order on motion to dismiss treated as a motion for summary judgment.

I sincerely regret taking any action that may further delay the trial of this case, but since the controversy on which the action is based is of such long standing, and a trial obviously would be very expensive and time-consuming, I feel that, if possible, issues raised by the pleadings should be decided in advance of the trial. For that reason, without passing upon the merits of the defenses of laches, statute of frauds, or statute of limitations (I have not come to any conclusion whatsoever as yet), I am today entering an order, copy of which will be mailed to you by the Clerk of the court, denying defendant's motion [65] to dismiss. The order allows the defendant twenty days in which to answer the second amended complaint.

I assume General Electric Company in its answer will affirmatively plead the three defenses to which I have above referred, and will renew its motion as a motion for summary judgment. I see no reason why the motion then could not be considered and passed upon by the court on the basis of the complaint and answer, and affidavits and other factual material already submitted in connection with the motion to dismiss, and on counsels' various mem-

oranda and lists of authorities heretofore submitted on the motion.

In making the foregoing suggestions, I have in mind that the motion for summary judgment should be disposed of in sufficient time to permit setting the case for trial in the October term of court in Spokane, if the motion for summary judgment is denied, and plaintiff wishes to try it at that time.

Yours very truly,

.....

United States District Judge.

SMD/b

cc—Clerk, U. S. District Court.

Received May 29, 1956. [66]

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[Title of District Court and Cause.]

STIPULATION EXTENDING TIME TO  
ANSWER COMPLAINT

It is hereby stipulated by and between Plaintiffs and General Electric Company that said Defendant may have until July 10, 1956, to answer Plaintiffs' second amended complaint dated this 11th day of June, 1956.

/s/ HARVE H. PHIPPS,

PHIPPS & PHIPPS,

Attorneys for Plaintiffs.

/s/ PHILIP S. BROOKE,  
HAMBLEN, GILBERT &  
BROOKE,  
Attorneys for Defendant,  
General Electric Company.

[Endorsed]: Filed June 11, 1956. [67]

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[Title of District Court and Cause.]

ORDER EXTENDING TIME TO  
ANSWER COMPLAINT

It appearing that the written stipulation on file herein of the Plaintiffs and the Defendant, General Electric Company extends the time for Defendant to answer the second amended complaint of the Plaintiffs to July 10, 1956;

Now therefore, It Is Ordered that the Defendant, General Electric Company, is allowed until July 10, 1956, in which to answer Plaintiffs' second amended complaint.

Dated this 12th day of June, 1956.

/s/ SAM M. DRIVER,  
United States District Judge.

Presented by:

/s/ PHILIP S. BROOKE,  
Attorney.

/s/ HARVE H. PHIPPS,  
PHIPPS & PHIPPS.

[Endorsed]: Filed June 12, 1956. [68]

[Title of District Court and Cause.]

## ANSWER OF DEFENDANT GENERAL ELECTRIC COMPANY

In Answer to the First Cause of Action in the Second Amended Complaint of the Plaintiffs, the Defendant General Electric Company Admits, Denies and Alleges, as Follows:

### I.

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph I, and therefore denies the same.

### II.

Answering paragraph II, defendant admits that the matter in controversy exceeds the sum of \$3,000.00 exclusive of interest and costs, and alleges that it is without knowledge or information to form a belief as to the truth of the remaining allegations contained in said paragraph, and therefore denies the same.

### III.

Admits the allegations contained in paragraph III.

### IV.

Admits the allegations contained in paragraph IV.

### V.

Answering paragraph V, defendant admits that on or about the 27th day of February, 1905, the defendant General Electric Company, acting [69] by

and through its duly qualified and authorized directors and officers, caused to be incorporated under the laws of the state of New York, the defendant Electric Bond & Share Company and that the defendant General Electric Company originally invested in and turned over to said Electric Bond & Share Company the sum of approximately one million three hundred thousand dollars (\$1,300,000.00) in cash, and assigned, transferred and set over to said Electric Bond & Share Company miscellaneous securities it then owned having a par value of approximately four million two hundred fifty-eight thousand, one hundred fifty dollars (\$4,258,-150.00), in return for which the said Electric Bond & Share Company issued and delivered to said General Electric Company all of its authorized and outstanding capital stock of said Electric Bond & Share Company, consisting of two million dollars (\$2,000,000.00) par value of its common stock and two million dollars (\$2,000,000.00) par value of its preferred stock, and denies the remaining allegations contained in said paragraph.

## VI.

Admits the allegations contained in paragraph VI; except that defendant has insufficient knowledge or information to form a belief as to the truth of, and defendant therefore denies, the allegations that:

(a) that the area referred to

"is and has been arid or semi-arid, the soil of which is of a volcanic ash character, highly porous,

and very productive when irrigated, but which, in its natural state, because of its location and the character of its soil is, and has been, unproductive and covered with sage brush and other vegetation which could grow and thrive without irrigation.”

(b) that the Columbia River

“has vast resources of water to be utilized and useful in the development of irrigation \* \* \* and when harnessed by a dam \* \* \* is capable of developing and generating and producing enormous electrical energy to be used and useful in the manufacturing and production of fertilizer, chemical products, pumping water for irrigation purposes, and other innumerable useful purposes.”

## VII.

Answering Paragraph VII, admits that the area or tract above [70] described as lying to the south of the Saddle Mountains and bounded as above described, has along its westerly boundary a portion of the Columbia River, which, because of the country surrounding it, and the vast amount of water behind it, is in its natural state a swiftly moving stream, dropping rapidly in elevation, and is known as and called “Priest Rapids,” and denies the remaining allegations contained in said paragraph.

## VIII.

Defendant alleges that it has insufficient knowledge or information to form a belief as to the truth

of the allegations in paragraph VIII, and therefore denies the same.

### IX.

Defendant alleges that it has insufficient knowledge or information to form a belief as to the truth of the allegations in paragraph IX, and therefore denies the same.

### X.

Answering paragraph X, admits that the Columbia River, at the site of said Priest Rapids, and above and below the same, is and was a navigable river, and alleges that it has insufficient knowledge or information to form a belief as to the remaining allegations contained in said paragraph, and therefore denies the same.

### XI.

Answering paragraph XI, defendant admits that the Columbia River was a navigable stream, and by reason thereof was under the control of the federal government, and denies the remaining allegations contained in said paragraph.

### XII.

Denies the allegations contained in paragraph XII.

### XIII.

Denies the allegations contained in paragraph XIII.

### XIV.

Answering paragraph XIV, defendant admits that one Charles A. [71] Coffin was a founder of de-

fendant, was its first president, and in 1913 and subsequent thereto was its Chairman of the Board, that one Sidney Z. Mitchell was in 1913 the president of Electric Bond and Share Company, and that in 1913 defendant was the sole stockholder of Electric Bond and Share Company, and denies the remaining allegations in said paragraph.

#### XV.

Denies the allegations contained in paragraph XV.

#### XVI.

Denies the allegations contained in paragraph XVI.

#### XVII.

Denies the allegations contained in paragraph XVI $\frac{1}{2}$ .

#### XVIII.

Denies the allegations contained in paragraph XVII.

#### XIX.

Denies the allegations contained in paragraph XVIII.

#### XX.

Answering paragraph XIX, defendant denies that any of the acts or matters therein alleged were "in furtherance and as a part of the performance of the said joint venture agreement on their part to be performed"; and defendant alleges that it has insufficient knowledge or information to form a belief as to the truth of the other allegations contained therein, and therefore denies the same.

XXI.

Answering paragraph XX,

(a) defendant denies the allegation that

"at the suggestion and upon the insistence of the defendant General Electric Company and its subsidiaries under its direction and control, and against the wishes of the plaintiffs, made an attempt to secure legislation which would cover the development of hydro-electric power not only on navigable rivers and streams, but also on non-navigable rivers and streams, and would extend the life of the license or permits to a term of ninety-nine (99) years \* \* \*";

(b) defendant admits that Congress enacted the Federal Water Power Act in 1920; and

(c) as to the other allegations in said paragraph XX, [72] defendant alleges that it has insufficient knowledge or information to form a belief as to the truth thereof and therefore denies the same.

XXII.

Defendant denies the allegations contained in paragraph XXI.

XXIII.

Defendant denies the allegations contained in paragraph XXII.

XXIV.

Answering paragraph XXIII, defendant denies all of the allegations contained therein, except that defendant admits the following facts:

1. That the public files of the Federal Power Commission, Washington, D. C., show that the Federal Power Commission issued a preliminary permit on March 3, 1921, to the Washington Irrigation and Development Company for a power project (Project No. 3) on the Columbia River at Priest Rapids; and
2. That a license was issued by said Commission to said Washington Irrigation and Development Company for said project on March 25, 1925.

XXV.

Denies the allegations contained in paragraph XXIV.

XXVI.

Denies the allegations contained in paragraph XXV.

XXVII.

Denies the allegations contained in paragraph XXVI except that defendant admits receiving a letter from plaintiffs dated June 14th, 1951, and admits that plaintiffs instituted the instant suit on or about July 16, 1952.

XXVIII.

Denies the allegations contained in paragraph XXVII (designated as "XXVI"), in the second amended complaint.

In Answer to the Second Cause of Action of the Second Amended Complaint, Defendant General Electric Company Admits, Denies and Al-leges: [73]

I.

Denies each and every allegation, matter and thing contained in said paragraph I except as to those matters and things admitted in defendant's answer to the first cause of action.

II.

Denies each and every allegation, matter and thing contained in paragraph II.

In Answer to the Third Cause of Action Contained in the Second Amended Complaint of the Plaintiff, Defendant General Electric Company Admits, Denies and Al-leges:

I.

Answering paragraph I, defendant admits that the Electric Bond & Share Company under the al-legations of the second amended complaint is a proper party defendant to this action, and denies the remaining allegations contained in said para-graph.

Affirmative Defense

Further answering said second amended com-plaint and for an affirmative defense thereto, this defendant alleges:

### First Defense

The complaint fails to state a claim against the defendant upon which relief can be granted.

### Second Defense

The court lacks jurisdiction to determine this controversy, because American Power & Light Company, a foreign corporation, and Electric Bond & Share Company, a foreign corporation, alleged by the plaintiffs to be parties to the joint venture agreement referred to in the second amended complaint are indispensable parties to this action, but are not subject to the jurisdiction of the court, and as to whom the attempted service of process has been quashed, pursuant to orders heretofore entered in this cause.

### Third Defense

That the joint venture agreement alleged to have been entered [74] into between the parties and this defendant in the year 1913, was never reduced to writing and signed by either of the parties, and by its terms was not to be performed within one year from the making thereof, and therefore void and unenforceable under Sec. 19.36.010 of the Revised Code of Washington.

### Fourth Defense

The claim stated in the second amended complaint did not accrue within three years before the commencement of this action, and is therefore barred

by the provisions of Sec. 4.16.090 Revised Code of Washington.

### Fifth Defense

That the joint venture agreement alleged to have been entered into between the plaintiffs and this defendant in the year 1913 (if it ever existed) was repudiated and abandoned by this defendant over 30 years ago; that the plaintiffs have been guilty of laches and unreasonable delay in bringing this action and are therefore barred from maintaining the same for the reason that the defendant has been greatly prejudiced and its position changed in the defense thereof, particularly by reason of the death many years ago of the officer and agent of the defendant corporation, General Electric Company, who allegedly entered into said agreement, namely, Charles A. Coffin, its former president; that this defendant has further been prejudiced by reason of the death of the officers and agents of the Electric Bond and Share Company who allegedly entered into said Joint Venture Agreement, namely Sidney Z. Mitchell, its former President, and Henry Pierce, former President of Washington Irrigation & Development Company; that defendant has been further prejudiced and its position changed in the defense of this action by reason of the fact that if any documents or records ever existed pertaining to said Joint Venture Agreement, the same have long ago been lost or destroyed and the defendant deprived of the proof necessary to defend this action.

Wherefore defendant prays that plaintiffs take nothing by their [75] action, and that the defendants do have and recover judgment against the plaintiffs for its costs of suit.

/s/ L. R. HAMBLEN,

/s/ PHILIP S. BROOKE,

HAMBLEN, GILBERT &  
BROOKE,

Attorneys for Defendant,

General Electric Company.

Service of copy acknowledged.

[Endorsed]: Filed July 10, 1956. [76]

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[Title of District Court and Cause.]

#### AFFIDAVIT OF WILLIAM J. DURKA

The Defendant General Electric Company submits the following Affidavit in support of its Motion for summary judgment:

Affidavit of William J. Durka

/s/ L. R. HAMBLEN,

/s/ PHILIP S. BROOKE,

HAMBLEN, GILBERT &  
BROOKE,

Attorneys for Defendant,

General Electric Company.

### Affidavit

William J. Durka, being duly sworn, deposes and says:

1. I am a member of the bar of the State of New York and am an employee of General Electric Company. I have my office at 570 Lexington Avenue, New York 22, N.Y.
2. On March 19, 1956, I made a personal check of the public files of the Federal Power Commission, in Washington, D. C., to ascertain what those files showed, from the inception of the Federal Power Commission to date, regarding power projects at Priest Rapids on the Columbia River in the State of Washington.

3. I ascertained the following facts:

(a) On June 12, 1920, the Washington Irrigation & Development Co. applied, under the Federal Water Power Act of 1920, for a preliminary permit for a power project (Project No. 3) on the Columbia River at Priest Rapids. The permit was granted on March 3, 1921, and pursuant thereto a license was issued to the Washington Irrigation & Development Co. in March, 1925—the exact date was either March 5 or March 25 (the records conflict)—which, as amended on March 3, 1927, required that construction be commenced on or before March 1, 1929. This license was terminated by the Commission on June 14, 1929, because of the licensee's failure to commence construction within the time required.

(b) On February 28, 1929, the Washington Irrigation & Development Co. filed an application for a new license for the same project that had been previously licensed.

On May 19, 1930, the Commission voted to deny the second license application because the applicant had failed to submit satisfactory evidence of its ability to market the power to be produced by the dam and to finance the proposed development. The executive [78] secretary of the Commission was authorized by the Commission's said action of May 19, 1930, to reject the second license application on July 1, 1930, if the applicant failed to supply the required evidence prior to such date.

On July 2, 1930, the Commission's executive secretary wrote to the applicant that, the required showing not having been made, the second license application was denied, and the file was closed.

(c) There was no activity regarding Priest Rapids on the Columbia River in the State of Washington, so far as is shown by the public files of the Federal Power Commission, from the closing of the file on July 2, 1930, on Project No. 3 of the Washington Irrigation & Development Co. to July 16, 1952, when plaintiffs instituted the instant suit.

4. Attached to this affidavit are the following documents:

(a) A certified copy of the Federal Power Commission's docket sheets on In The Matter of Washington Irrigation & Development Co., Project No. 3.

These docket sheets detail the entire official history of Project No. 3.

(b) A certified copy of the above-mentioned letter of July 2, 1930, from the Commission's executive secretary to Mr. Henry J. Pierce, President, Washington Irrigation & Development Company.

(c) The minutes of the meeting of the Federal Power Commission held on May 19, 1930, insofar as they pertain to Priest Rapids, as reported in the Commission's Tenth Annual Report.

/s/ WILLIAM J. DURKA.

Subscribed and sworn to before me this 15th day of June, 1956.

[Seal] /s/ VIRGINIA C. HOGAN,  
Notary Public. .

My Commission Expires March 30, 1958. [79]

Minutes of the One Hundred and Fifth Meeting (May 19, 1930) of the Federal Power Commission (As Reported In Appendix A of "Tenth Annual Report of the Federal Power Commission: 1930" For the Fiscal Year Ended June 30, 1930)

Pages 120-121:

#### "REJECTION OF APPLICATION

"The executive secretary stated that Washington Irrigation & Development Co. was granted a pre-

liminary permit on March 3, 1921, for a power project (No. 3) on the Columbia River, in Grant, Kittitas, and Yakima Counties, Wash., and pursuant thereto a license was issued March 25, 1925, which, as subsequently amended, required that construction be begun on or before March 1, 1929. This the licensee was unable to do, and the commission, at its ninety-eighth meeting, on June 14, 1929, voted to terminate the license. The company had, on February 28, 1929, made application for a new license for the same project. This application is incomplete, in that the exhibits and general design drawings do not fully comply with the rules and regulations of the commission, and the plans and analyses of the proposed structures are inadequate to enable the commission's staff and representatives to reach a decision as to their safety, stability, and adequacy. The applicant was requested to submit by May 1, 1930, a definite showing of its ability to market the power and finance the development. This it has been unable to do. It is accordingly recommended that the application for license be rejected.

"The commission thereupon took action as follows:

"In the matter of the application of Washington Irrigation & Development Co., a corporation organized under the laws of the State of Maine, for a license under the Federal water power act for a power project (No. 3) on Columbia River, in Grant, Kittitas, and Yakima Counties, State of Washington, involving the construction of a dam, power

house, and appurtenant works: Said applicant having failed to submit satisfactory evidence of its ability to market the power and finance the development, the commission authorized the executive secretary to reject said application on July 1, 1930, provided that prior to such date the applicant has failed to supply the required evidence." [80]

XP-3-Washington

Washington Irrigation & Development Co.

July 2, 1930.

Mr. Henry J. Pierce,  
President, Washington Irrigation & Development  
Company,  
3 Rector Street,  
New York, N.Y.

Dear Sir:

As you were notified by my letter of May 20, 1930, the Commission at its meeting of May 19, voted to authorize the rejection of your application for license for your proposed power development on Columbia River, unless on or before July 1, a satisfactory showing could be made of ability to finance the project and market the power.

No such showing having been made, you are hereby notified that your application is hereby rejected and the case closed as of this date.

Very truly yours,

F. E. BONNER,

Executive Secretary.

FFH/HLA

3 Copies to Chief of Engineers,

2 copies to Bureau of Fisheries.

Duly certified.

Service of copy acknowledged.

[Endorsed]: Filed July 10, 1956. [83]

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[Title of District Court and Cause.]

### MOTION FOR SUMMARY JUDGMENT

The defendant, General Electric Company, a corporation, by its undersigned attorneys, hereby moves the court to enter summary judgment for this defendant and in support of said motion in accordance with the provisions of Rule 56 (b) and (c) of the Rules of Civil Procedure the defendant refers this Court to the Affidavits of Ray H. Luebbe, B. H. Kizer, Philip S. Brooke, John W. Bremer, and Milton E. Dam, and counsel's various memoranda and lists of authorities heretofore submitted in connection with defendant's motion to dismiss this action. In addition, in order to clarify the exact dates of official actions by the Federal Power Com-

mission regarding Priest Rapids, an affidavit of William J. Durka is submitted herewith.

/s/ L. R. HAMBLEN,

/s/ PHILIP S. BROOKE,

HAMBLEN, GILBERT &  
BROOKE,

Attorneys for Defendant,  
General Electric Company.

Service of copy acknowledged.

[Endorsed]: Filed July 10, 1956. [88]

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[Title of District Court and Cause.]

MOTION FOR ADJOURNMENT OF HEARING  
ON SUMMARY JUDGMENT MOTION

Come now the plaintiffs and move the court for an order continuing and adjourning the hearing on the motion of the defendant, General Electric Company, for summary judgment herein under Rule 56 of the Federal Rules of Civil Procedure until the trial of the above-entitled action under the issues of facts alleged in the plaintiffs' Second Amended Complaint and denied by the defendant, General Electric Company, in its answer filed herein July 10th, 1956, for the reasons and upon the grounds that there are genuine issues of material facts in this action and because of such issues the court cannot determine as a matter of law that the de-

fendant is entitled to a summary judgment under the said Rule.

This motion will be based upon all of the records and files in this action, including the records of the proceedings heretofore had in this court in connection with the settlement and formation of the issues herein, and the affidavit of Harve H. Phipps, Sr., attached hereto.

Dated this 20th day of July, 1956.

PHIPPS & PHIPPS,

By /s/ HARVE H. PHIPPS, SR.,

Attorneys for Plaintiffs. [89]

[Title of District Court and Cause.]

AFFIDAVIT OF HARVE H. PHIPPS, SR., IN  
SUPPORT OF MOTION FOR ADJOURN-  
MENT OF HEARING OF MOTION FOR  
SUMMARY JUDGMENT

State of Washington,  
County of Spokane—ss.

Harve H. Phipps, Sr., being first duly sworn on his oath, says that he is one of the attorneys for the plaintiffs in the above-entitled action and makes this affidavit on behalf of said plaintiffs in support of plaintiffs' motion for adjournment of the hearing on defendant's motion for summary judgment under

Rule 56 of the Federal Rules of Civil Procedure filed herein July 10th, 1956.

As more fully appears from the records and files herein, summons and complaint herein were served prior to and were filed herein July 16th, 1952, the defendant General Electric Company, a corporation, by dilatory motions and other tactics has delayed the joining of issue herein until July 9th, 1956, when it served its answer herein, which was filed in this court July 10th, 1956, and on the same days of serving and filing its answer, the said defendant General Electric Company, a corporation, also served and filed a Motion for Summary Judgment, for the obvious purpose of further delaying the trial of this action on the issues raised and joined by plaintiffs' Second Amended Complaint and the Answer [90] of the defendant, General Electric Company.

An inspection and examination of the allegations in plaintiffs' Second Amended Complaint in connection with the admissions and denials contained in the answer of the defendant, General Electric Company, discloses that there are genuine issues of material facts, which will require the production of evidence to resolve, and which cannot be determined from the pleadings, depositions and admissions, or the affidavits on file herein, and more in particular as follows:

## I.

By paragraphs I and II of its answer the defendant, General Electric Company, denies knowledge

or information sufficient to form a belief as to the citizenship and residence of the plaintiffs and further denies knowledge or information sufficient to form a belief as to whether or not the General Electric Company, a corporation, was organized and existing under laws foreign to the state of Washington.

## II.

That whereas it is admitted in paragraph V of said answer that the defendant, General Electric Company, caused the Electric Bond & Share Company to be incorporated under the laws of the state of New York and further admits that:

"the defendant, General Electric Company, originally invested in and turned over to said Electric Bond & Share Company the sum of approximately one million three hundred thousand dollars (\$1,300,000.00) in cash, and assigned, transferred and set over to said Electric Bond & Share Company miscellaneous securities it then owned having a par value of approximately four million two hundred fifty-eight thousand, one hundred fifty dollars (\$4,258,150.00), in return for which the said Electric Bond & Share Company issued and delivered to said General Electric Company all of its authorized and outstanding capital stock of said Electric Bond & Share Company, consisting of two million dollars (\$2,000,000.00) par value of its common stock and two million dollars (\$2,000,000.00) par value of its preferred stock,"

and the said defendant, General Electric Company, in and by said paragraph V of said answer denies the following allegations in [91] said paragraph V of plaintiffs' Second Amended Complaint, to wit:

### First

After admitting that the defendant, General Electric Co., caused the incorporation of the corporation Electric Bond & Share Company, such defendant denies: That said corporation was organized,

"for the apparent and ostensible object and purpose, on the part of the said General Electric Company (1) to realize as fully as possible upon various utility securities which it had acquired in the process of selling and disposing of its manufactured equipment; (2) to obtain for itself, the said General Electric Company, a direct proprietary stake or interest in a promising young industry, that is to say, the production and development of electrical and other power, with which industry it was then closely related and affiliated; and, (3), to utilize the position it would acquire as a proprietary factor in the utility industry to capitalize and advance the sales of equipment and appliances manufactured, developed and improved, or to be manufactured, developed or improved by said General Electric Company \* \* \*";

and further, after admitting that in return for transferring to Electric Bond & Share Company

certain cash and securities, as above admitted, the defendant, General Electric Company, denies that:

"thereby the General Electric Company became the company holding all of the issued and outstanding common and preferred stock of Electric Bond & Share Company, and was and became what is commonly known and described variously as the 'holding company,' the 'parent company' or the 'dominant company,' and by and through such stock ownership, and the voting rights and powers reposed in it by reason of such stock ownership, the said General Electric Company in all things dominated and controlled the management, activities, acts and actions of the defendant Electric Bond & Share Company, and by such domination and control the defendant General Electric Company used the purported corporate entity of the defendant Electric Bond & Share Company for its own uses and purposes, and there was thereby created a confusion of corporate entities so as to mislead and deceive third persons dealing with the said defendant Electric Bond & Share Company, and the purported corporate entity of said Electric Bond & Share Company was in truth and in fact a fiction, and the fiction of such purported separate legal entity of the defendant Electric Bond & Share Company was used by the defendant General Electric Company as a means in perpetrating an ostensible fraud and deception upon persons dealing with

the said Electric Bond & Share Company, a purported separate legal entity, incorporated, organized and existing for the declared objects and purposes, among others, of buying, selling, handling and dealing in bonds and other securities, principally of utility companies, and was in truth and in fact a mere tool or business conduit of the defendant General Electric Company, through which the said defendant General Electric Company utilized and employed it as a means of perpetrating a monopoly not only for the sale [92] and distribution of its manufactured electrical equipment, appliances and products, but, as hereinafter set out, to monopolize the creation, production and manufacturing of electrical and other power, and the distribution of the same and the development and use of water and water power for irrigation and other purposes, and the procuring of sites, lands and mineral deposits, building and other materials, useful and to be used in the development of power projects, in all of which ventures the said dominant or parent corporation, General Electric Company, used and utilized the defendant Electric Bond & Share Company for the purpose of financing and raising funds by the sale of bonds and other securities to the investing public, and as the direct and proximate result of its dominion and control of the said Electric Bond & Share Company, and the financial aid and assistance created for the General Electric Company by the

defendant Electric Bond & Share Company, said General Electric Company was able to and did become the world's largest manufacturing company of electrical appliances and equipment, dominating and monopolizing a great or major portion of the field of such industry, and in addition thereto, as hereinafter set out, created and dominated the field of the manufacturing and distribution of electrical energy and power as well as developing water power in the production, creation and manufacturing of such electrical energy and power, all of which was made possible through the fiscal and financial agency of the defendant Electric Bond & Share Company, so dominated and controlled by the General Electric Company."

It is the position of the plaintiffs that by the denial of the above-quoted portions of paragraph V of plaintiffs' Second Amended Complaint the defendant General Electric Company has created issues of material facts, which cannot be resolved without evidence and that the defendant is not entitled to summary judgment under Rule 56, Federal Rules of Civil Procedure, and particularly under subdivision (c) of said Rule which only authorizes or permits the court to direct the entry of a summary judgment:

"\* \* \* if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any

material fact and that the moving party is entitled to judgment as a matter of law."

### III.

That with reference to paragraph VI of defendant's answer, responsive to paragraph VI of plaintiffs' Second Amended Complaint, although the defendant has admitted certain allegations therein contained, the defendant has pleaded lack of knowledge or [93] information sufficient to form a belief, and therefore denies the allegations of said paragraph VI quoted as (a) and (b) in said paragraph VI of defendant's answer, and thereby created an issue of fact, which will require the plaintiffs to produce evidence as to such allegations, and such issue cannot be determined by the court as a matter of law, but must be *must be* determined as a matter of fact on evidence to be produced by the plaintiffs.

### IV.

With reference to paragraph VIII of defendant's answer, responsive to paragraph VIII of plaintiffs' Second Amended Complaint, the defendant has pleaded that it has insufficient knowledge or information to form a belief as to the truth of the allegations in said paragraph VIII, and therefore denies the same, which will require the plaintiffs to produce evidence as to such allegations, and such issues cannot be determined by the court as a matter of law, but must be determined as a matter of fact, on evidence to be produced by the plaintiffs. The same is true with reference to paragraph IX of

defendant's answer, responsive to paragraph IX of plaintiffs' Second Amended Complaint.

## V.

With reference to paragraph X of defendant's answer, responsive to paragraph X of plaintiffs' Second Amended Complaint, although the defendant admits in its answer that the Columbia River at the site of Priest Rapids and above and below the same is and was a navigable river, the defendant alleges that it has insufficient knowledge to form a belief as to the other allegations of said paragraph X of said Second Amended Complaint and on that ground denies the same, which will require the plaintiffs to produce evidence as to such other allegations, and such issues cannot be determined by the court as a matter of law, but must be determined as a matter of fact, on evidence to be produced by the plaintiffs. [94]

## VI.

With reference to paragraph XI of defendant's answer, responsive to paragraph XI of plaintiffs' Second Amended Complaint, although the defendant admits that the Columbia River was a navigable stream and by reason thereof was under the control of the Federal Government, the defendant denies that:

"For a time, covering a period of approximately three years prior to 1913, the defendant General Electric Company had under consideration the project of developing the Priest

Rapids site on said Columbia River primarily as a source of electrical power and energy, for which purpose it would be necessary to span the said Columbia River from bank to bank and construct a high dam across said river, \* \* \*,

and thereby created issues of material facts which cannot be resolved without evidence, and cannot be determined as a matter of law.

## VII.

With reference to paragraphs XII and XIII of defendant's answer, responsive to paragraphs XII and XIII of plaintiffs' Second Amended Complaint, the defendant has denied the allegations of both of said paragraphs XII and XIII, thereby creating issues of material facts which cannot be resolved without evidence, and cannot be determined as a matter of law.

## VIII.

With reference to paragraphs XIV, XV, XVI, XVII, XVIII, XIX, XX, XXI, XXII, XXIII, XXIV, XXV, XXVI, XXVII and XXVIII of the defendant's answer, responsive to paragraphs XIV, XV, XVI, XVI $\frac{1}{2}$ , XVII, XVIII, XIX, XX, XXI, XXII, XXIII, XXIV, XXV, XXVI and XXVII of plaintiffs' Second Amended Complaint, the defendant has denied the material allegations of said paragraphs, and thereby created issues of material facts which cannot be resolved without evidence, and cannot be determined as a matter of law.

## IX.

With reference to all of defendant's answers to the Second and Third Causes of Action in plaintiffs' Second Amended Complaint, the defendant has denied all of the material allegations [95] of said Second and Third Causes of Action and thereby created issues of material facts which cannot be resolved without evidence, and cannot be determined as matters of law.

It will be noted from the allegations of the Second Amended Complaint, and particularly the paragraph designated XVI thereof, under the joint venture agreement the plaintiffs agreed on their part to perform certain acts and aid, assist, work and co-operate with the General Electric Company and/or "subsidiaries, subholding corporations and agents" in accomplishing the objects and purposes of such joint venture agreement, and the defendant has generally denied such allegations, thereby creating a material issue of fact. However, in view of the admission in the paragraph designated V of defendant's answer that the defendant General Electric Company caused Electric Bond & Share Company to be incorporated and caused all of the capital stock, both common and preferred, to be issued to it, and dominated and controlled the said Electric Bond & Share Company, and of the Findings of the Securities and Exchange Commission In the Matter of Electric Bond and Share Company, American Power & Light Company and other corporations therein named, found in Vol. 11 of Securities and

Exchange Commission Reports and Decisions, found commencing on page 1146, that the American Power & Light Company was a mere subsidiary of Electric Bond and Share Company, and the further fact that American Power & Light Company, in turn caused the incorporation of Washington Irrigation & Development Company, and that the plaintiffs in performing their portion of the joint venture agreement worked and co-operated with all three corporations. Electric Bond & Share Company, American Power & Light Company and Washington Irrigation & Development Company, the defendant can furnish great aid to the court in reaching a sound and proper conclusion with reference to the joint venture agreement affecting the Priest Rapids Project by admitting these facts instead of evading the true facts and requiring the plaintiffs to make this proof the "hard" way. [96]

There are so many disputed facts and controversial matters in this case as appear from the Second Amended Complaint and the defendant's answer, that it would take an endless amount of time, and work to discuss them all, a considerable amount of which can be avoided if the Federal Rules of Civil Procedure, and particularly Rule 1, that the rules shall be construed "to secure the just, speedy and inexpensive determination of every action" are followed and respected.

What the plaintiffs desire in this case is an opportunity to present the facts to the court, free from legal technicalities and dilatory tactics, so that a

just, speedy and inexpensive determination of this action can be had.

To the end that the court may have the benefit of the Report and Decision of the Securities and Exchange Commission in the above-mentioned decision, I am handing you herewith Volume 11 of the Securities and Exchange Commission's Reports and Decision in which you will find the above-mentioned case, commencing at page 1146.

/s/ HARVE H. PHIPPS.

Subscribed and sworn to before me this 31st day of July, 1956.

/s/ HARVE H. PHIPPS, JR.,  
Notary Public, State of Washington, Residing at  
Spokane, Washington.

Service of copy acknowledged.

[Endorsed]: Filed July 31, 1956. [97]

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[Title of District Court and Cause.]

**ORDER STRIKING MOTION FOR ADJOURNMENT OF HEARING ON SUMMARY JUDGMENT MOTION.**

Prior to July 31, 1956, defendant General Electric Company had filed herein a motion for summary judgment supported by affidavits. The court had the motion under advisement and had indicated that counter affidavits submitted by plaintiffs in resist-

ance to a former motion for summary judgment would be considered also. On the above-mentioned date, plaintiffs filed herein a "Motion for Adjournment of Hearing on Summary Judgment Motion." The "grounds" of the motion, as stated therein, are "that there are genuine issues of material facts in this action and because of such issues the court cannot determine as a matter of law that the defendant is entitled to a summary judgment \* \* \*."

There is no basis in the Rules of Civil Procedure for a motion to adjourn a motion. Moreover, plaintiffs' motion merely raises by another separate motion an issue now before the court for determination on defendant's motion for summary judgment.

Now, Therefore, plaintiffs' motion for adjournment of hearing on summary judgment motion is Ordered stricken, and the clerk of this court is directed to strike the same from the files in the above-entitled cause.

Dated this 8th day of August, 1956.

/s/ SAM M. DRIVER,

United States District Judge.

[Endorsed]: Filed August 8, 1956. [98]

Chambers of  
Sam M. Driver  
United States District Judge  
Spokane 10, Washington

Pasco,

August Eighth, 1956.

Phipps & Phipps,  
Attorneys at Law,  
Columbia Building,  
Spokane, Washington;

Hamblen, Gilbert & Brooke,  
Attorneys and Counselors,  
Paulsen Building,  
Spokane 1, Washington.

Gentlemen:

Re: Dam Brothers v. General Electric Co.,  
et al.—No. 1036.

On my own motion, I have entered an order striking plaintiffs' motion to adjourn defendant's motion for summary judgment. There is no provision in the rules for such a motion. In the present case it merely presents again a crucial question before the Court on the summary judgment motion; namely, as to each affirmative defense alleged by defendant, is there a genuine issue of material fact? If there is such an issue, the motion will be denied.

I wish to avoid establishing a precedent for a motion to adjourn a motion. If it is allowable in the instant case, I see no reason why it could not

be used against motions to dismiss, motions for more particular statement, et cetera.

The rules provide for a motion for summary judgment and, when a party in good faith files such a motion he has the right to have it decided by the Court. I think the motion in the instant case was presented in good faith to secure, if possible, a ruling on the defendant's affirmative defenses without a protracted, expensive trial on other disputed factual issues. Much of the delay, of which plaintiffs now complain, has been due to the Court's insistence that the affirmative defenses be pleaded in an answer before the motion for summary judgment could properly be made or considered. And I thought it was understood that in passing upon the motion I would consider all the relevant material—factual and legal—in the file of the case.

Plaintiffs' motion to adjourn the motion, if it were not stricken, would delay rather than expedite a trial on the merits. The motion would have to be set down for hearing at the next [99] motion day in Spokane, which will be early in October. I intend to rule on the motion for summary judgment before the end of this month.

Yours very truly,

.....,

United States District Judge.

SMD/b

cc: Clerk, United States District Court.

Received August 9, 1956. [100]

[Title of District Court and Cause.]

## OPINION OF THE COURT

Honorable Sam M. Driver, Judge.

Defendant, General Electric Company, has moved for summary judgment. The motion is based upon a number of grounds, but only limitation and laches, set up as affirmative defenses in defendant's answer, will be discussed. The others clearly appear to involve genuine issues of material fact and will not, therefore, be considered.

The second amended complaint, as further amended by deletion and interlineation, consists of three "causes of action," The third involves only a defendant not now before the court. The allegations of the first "cause of action," insofar as they are pertinent to the present inquiry, may be briefly summarized as follows:

The plaintiffs, who had for some time conducted investigations, surveys, and studies of the feasibility of developing and utilizing the Priest Rapids site on the Columbia River in the state of Washington (primarily for the irrigation of a large area of adjacent arid land, and, secondarily, for the generation of electric power), in 1910 formed a partnership for the furtherance of that project. The partnership operated under the name of Dam Brothers and through the contributions of the individual members, and by their joint efforts, the partnership acquired the control of the lands in what was known as the Priest Rapids Highlands Project, consisting of approximately 135,000 acres

of land owned by approximately 1000 landowners. Originally plaintiffs contemplated diverting the waters of the river for irrigation without constructing a dam or other obstruction to navigation.

For about three years prior to 1913, defendant had been considering the development of the Priest Rapids site, primarily for electric power purposes by the construction of a high dam across the river. Defendant encountered serious difficulties, however. It discovered that its plans would interfere with the project of plaintiffs and that the Columbia River was a [102] navigable stream under the control of the Federal government, and that the development of a hydroelectric power project at Priest Rapids was not feasible until favorable amendment of the Federal laws pertaining thereto could be secured.

On learning of such obstacles, defendant proposed to plaintiffs that they jointly develop the Priest Rapids project for both power and irrigation purposes and suggested that a meeting be held in New York City to work out the details of such a joint enterprise.

The meeting was held and the principal representative of defendant was Charles A. Coffin, originally its president and then chairman of its board of directors. Defendant also was represented by Sidney Z. Mitchell, President and Managing Director of Electric Bond & Share Company (a corporation completely dominated and controlled by defendant), and Henry Pierce, also connected with Electric Bond & Share Company. As a result of the meeting and negotiations carried on in the year

1913, the plaintiffs, and the defendant through its agents Coffin, Mitchell and Pierce, entered into an oral joint venture agreement for the development of the Priest Rapids site.

In the joint venture agreement, the plaintiffs on their part agreed to (1) abandon their own plans to develop Priest Rapids and join with defendant in the development thereof; (2) assist in securing additional power and industrial sites and lands to be turned over to defendant and its subsidiaries for construction of a dam for the generation of power and for irrigation purposes upon the passage of favorable Federal legislation; (3) make available to defendant all of plaintiffs' "records, investigations, field logs, field work and knowledge" with reference to the irrigation and power development; (4) jointly acquire with defendant 55,000 acres controlled by plaintiffs, being railroad grant lands, and to endeavor to secure control over other privately-owned lands in furtherance of the irrigation feature of the joint project; and (5) employ plaintiffs' resources and efforts to obtain the enactment by the Congress of the United States of favorable [103] water power legislation which would make it feasible to develop the Priest Rapids site.

On its part, defendant by the joint venture agreement, undertook to (1) "allot" to plaintiffs \$500,000 worth of common stock of a corporation to be known as the Priest Rapids Power Company which defendant would cause to be organized and incorporated with par value capital stock of \$40,000,000

upon the passage of favorable legislation affecting the Priest Rapids power site; (2) give plaintiffs a 30% interest in a land-holding "syndicate" to be formed immediately following the making of the joint venture agreement for the purpose of acquiring the 55,000 acres of railroad grant land, which syndicate was to be jointly controlled by plaintiffs and defendant; (3) deliver to plaintiffs a 10% stock interest in corporations to be formed, to be known as the Terminal Townsite Company "and other companies" for the purpose of developing industrial and transportation facilities in the vicinity of the Priest Rapids site, which corporations were to be formed and organized "immediately following" the passage of favorable Federal power site legislation; (4) allot and deliver to plaintiffs a 10% interest "in any and all of the various syndicates or corporations" to be formed or organized for the purpose of acquiring or developing mineral rights, minerals, and building materials in connection with the Priest Rapids project; and (5) directly and through its subsidiaries, furnish all necessary funds and pay all expenses "during the preconstruction and construction period," and "diligently prosecute all necessary activities and perform all acts necessary or required for the fruition and realization of the plans and prospects of the parties for the development of said Priest Rapids site for power and irrigation purposes."

Plaintiffs generally performed their part of the joint venture agreement and specifically assisted in

various ways in securing the enactment of favorable water power legislation by the Congress of the United States. The passage of the legislation was delayed because of the insistence of the defendant upon the inclusion of provisions which the Congress would not accept; but such legislation was enacted into law in March, 1920. [104]

In further performance of the joint venture agreement plaintiffs acquired "for the land syndicate formed for such purpose" the 55,000 acres of land for irrigation, and other lands; and acquired Tufa mineral deposits immediately adjacent to the proposed dam and townsite, which deposits, it was agreed, were to be turned over to a corporation to be organized as the Tufa Natural Cement Company.

After the enactment of the favorable water power legislation in 1920, defendant through its various subsidiaries procured a permit, and later, a license, to construct the proposed dam at Priest Rapids, and performed preliminary diamond drilling and engineering work in preparation for the construction of the dam. The permit was granted about the year 1925. Defendant assured plaintiffs that it intended to proceed immediately with the construction of the proposed project, and plaintiffs believed and relied upon such assurance.

Defendant at no time abandoned the performance of the joint venture agreement on its part and at all times advised and assured plaintiffs that it still intended to proceed with the proposed plans, which assurance plaintiffs believed and relied upon, but

defendant was hindered and delayed in the prosecution of the work by the general economic depression which began in 1929, and, later on, by the Second World War.

Just prior to the commencement of the action, plaintiffs learned that a subsidiary of defendant had secretly sold and disposed of lands of the land syndicate, thus putting it beyond the power of the defendant to perform the joint venture agreement. On June 14, 1951, plaintiffs made written demand upon defendant to complete the performance of the joint venture agreement, to which demand there was no response. The present action was then instituted promptly. (The complaint was filed on July 16, 1952.)

As a direct and proximate result of defendant's failure to perform the joint venture agreement, and the necessary change of position of plaintiffs brought about by the performance of their part of the agreement, plaintiffs have been injured and damaged in the total sum of \$8,550,000. [105]

In the second cause of action plaintiffs incorporate by reference all the allegations of the first cause of action, and in addition thereto allege in substance that defendant used the knowledge, experience and efforts of the plaintiffs during the period covered by the joint adventure and as a result thereof obtained favorable Federal water power legislation "and other advantageous positions and situations" from which defendant received "enor-

mous profits" which cannot now be determined by these plaintiffs.

In the prayer of the second amended complaint the court is asked to find that (1) the parties made the joint venture agreement; (2) the defendant has "wholly failed, neglected and refused to complete, carry out and perform \* \* \*" the same, and has "put it beyond its power to so perform"; and (3) as a result of defendant's failure to perform, the plaintiffs have materially changed their position and have been injured and damaged thereby in the sum of not less than \$8,550,000.

The following additional uncontested facts appear in affidavits and other documents filed in support of the motion for summary judgment:

Charles A. Coffin, who was the first president of General Electric Company, was 69 years of age when the oral joint venture agreement was alleged to have been made in 1913. He retired in 1922, and died July 14, 1926. Henry J. Pierce died at some time prior to 1935. Sidney Z. Mitchell, a former president of Electric Bond and Share Company, died February 17, 1944.<sup>1</sup>

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<sup>1</sup>In an affidavit resisting the motion for summary judgment, plaintiff Milton E. Dam mentioned Edwin W. Rice, Jr., "President, associate and assistant of Mr. Coffin," as taking some part in the making of the oral joint venture agreement, but according to an uncontradicted counteraffidavit, Edwin W. Rice, Jr., who was president of defendant corporation from 1913 to 1922, died November 25, 1935.

Diligent search and inquiry by one of defendant's attorneys has failed to disclose that Priest Rapids Power Company, Terminal Townsite Company, or Tufa Natural Cement Company were [106] ever incorporated, and the records of the Secretary of State of the State of Washington, the official custodian of corporate records, show that none of the three corporations just named has qualified to do business in that state either as a foreign or domestic corporation, subsequent to the year 1912.

The following appears from the records of the Federal Power Commission in Washington, D. C.: On June 12, 1920, the Washington Irrigation & Development Co.,<sup>2</sup> under the Federal Water Power Act of 1920, applied for a preliminary permit for a power project (Project No. 3) on the Columbia River at Priest Rapids. The permit was granted on March 3, 1921, followed by the issuance of a license to the company in March, 1925. A requirement of the license was that construction be commenced on or before March 1, 1929. The license was terminated by the Commission on June 14, 1929, because of the licensee's failure to commence construction within the required time. On February 28, 1929, the company had filed an application for a new license for the same project, which second application was denied by the Commission on July 1, 1930, for the reason that the applicant had failed to submit satis-

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<sup>2</sup>For the purpose of deciding the motion for summary judgment it will be assumed that the company was a dominated subsidiary and agent of defendant.

factory evidence of its ability to market the power to be produced and to finance the proposed development. On July 2, 1930, the Commission's executive secretary notified the applicant by letter that the second application was denied and the file was closed. Thereafter, there was no activity regarding Priest Rapids on the Columbia River in the state of Washington after rejection of the application and closing of the file on Project No. 3 of the Washington Irrigation and Development Company to July 16, 1952, when the present action was instituted.

This court's jurisdiction is based upon the diversity of citizenship of the parties and the substantive law to be applied is the law of the state of Washington.<sup>3</sup> The parties are to have the same kind of trial they would have in the state court, [107] and any law of the state which would substantially affect the outcome of the lawsuit must be regarded as substantive and be followed by the federal court.<sup>4</sup> It is a well-established general rule that all matters of procedure, such as the limitation of time in which an action may be brought, where the limitation per-

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<sup>3</sup>Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188.

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<sup>4</sup>Guaranty Trust Co. v. York, 326 U.S. 99, 65 S.Ct. 1464, 89 L.Ed. 2079; Angel v. Bullington, 330 U.S. 183, 67 S.Ct. 657, 91 L.Ed. 832; Ragan v. Merchants Transfer Co., 337 U.S. 530, 69 S.Ct. 1233, 93 L.Ed. 1520; Woods v. Interstate Realty Co., 337 U.S. 535, 69 S.Ct. 1235, 93 L.Ed. 1524.

tains to the remedy rather than the right, are governed by the law of the forum.<sup>5</sup> It is my view, therefore, that the law of the state of Washington is controlling as to whether or not plaintiffs' action was commenced within the time limited by law.

Plaintiffs' first cause of action clearly appears to present a claim for damages for breach of an oral contract. Plaintiffs in one of their written briefs referred to it as an action for specific performance of a contract. The reference is not warranted in view of the allegations of the second amended complaint that, defendant has by its conduct made performance on its part impossible. Moreover, one of the principal objects of the contract was the construction of a dam across the Columbia River at the Priest Rapids site for the generation of electrical energy, and the court will take judicial notice that a permit for the building of such a dam at the same site has been issued by the Federal Power Commission to the Grant County Public Utility District, and at least preliminary work on the project has been commenced. RCW 4.16.080, subd. (3), provides that, "An action upon a contract or liability express or implied, which is not in writing, and does not arise out of any written instrument" must be commenced within three years after the cause of action accrued. The statute by its express terms applies to plaintiffs' first cause of [108] action.

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<sup>5</sup>Restatement, Conflict of Laws, § 585, p. 702; 15 C.J.S. Conflict of Laws, § 22, p. 948.

The second cause of action presents a claim for recovery for unjust enrichment of the defendant. Although an action based on such a claim is equitable in its nature,<sup>6</sup> the Washington State Supreme Court has squarely and unequivocally held in two recent cases that the three-year statute of limitations mentioned above is applicable to an action for unjust enrichment.<sup>7</sup>

Both causes of action must depend upon the existence of the oral contract. The first, as has been stated, is to recover damages for its breach. The second, which necessarily must be alternative, is based upon the principle that, if for any reason the contract is legally unenforceable, then plaintiffs are entitled to recover for the unjust enrichment of defendant which has resulted from the performance by plaintiffs of their obligations under the contract. The right of action on both causes of action accrued when defendant breached the contract and made it clear by its acts and conduct that its part of the contract would not be performed.

By the oral joint venture contract, defendant agreed immediately after the passage of Federal water power legislation to organize a corporation to be known as the Priest Rapids Power Company

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<sup>6</sup>Bill v. Gattavara, 34 Wn. 2d 645, 650, 209 P. 2d 457. See, also, Lloyd v. Ridgefield Lbr. Ass'n, 38 Wn. 2d 723, 231 P. 2d 613.

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<sup>7</sup>Halver v. Welle, 44 Wn. 2d 288, 266 P. 2d 1053 (En Banc, Feb. 19, 1954); Geranios v. Annex Investments, 45 Wn. 2d 233, 273 P. 2d 793.

with a capital stock of \$40,000,000, and to turn over \$500,000 worth of the stock to the plaintiffs; to organize a corporation to be known as the Terminal Townsite Company, and transfer 10% of the stock to plaintiffs; and diligently to build a dam across the Columbia River at the Priest Rapids site, and allied works for the generation of electrical energy, and the irrigation of arid lands. The passage of the Federal water power legislation occurred in March, 1920. There is no allegation that defendant caused any corporations to be incorporated or transferred any stock in any corporation to the plaintiffs. It may properly be [109] inferred from the defendant's uncontroverted showing on that point that no corporation was ever organized. Defendant's failure to do so breached the contract. Defendant did not build the dam and plaintiffs did not commence their action until 32 years after the passage of the Federal water power act. Defendant did procure a license from the Federal Power Commission to build the dam, it is true, but the license was finally canceled and the file closed on July 2, 1930. The file was never reopened. The very fact that defendant during the ensuing 19 years made no further application for a permit to build the dam should have been sufficient indication to anyone making inquiry that the project had been abandoned so far as defendant was concerned. Under the facts as above stated, it seems clear that plaintiffs' causes of action must have accrued at least 3 years prior to July 16, 1952. Let us assume that under the same state of

facts plaintiffs had brought this same action against defendant on July 1, 1949. What, may we suppose, would have been the prospects of a successful defense to the action on the ground that it had been prematurely brought—that 29 years was not a sufficient, reasonable time to allow defendant for performance of its part of the oral agreement?

In the numerous written memoranda and lengthy affidavits submitted by plaintiffs and their attorneys, expression is repeatedly given to the thought that the instant case is a very unusual one and, because of its peculiar circumstances, plaintiffs are entitled to equitable relief and the statute of limitations should not be interposed to bar recovery. If both causes of action should be regarded as equitable in character, recovery would nevertheless be precluded because of laches on the principles announced and applied by the Supreme Court of Washington in *Teeter v. Brown*, 130 Wash. 506, 228 Pac. 291, and *Kilbourne v. Kilbourne*, 156 Wash. 439, 287 Pac. 41. In each of the cases the plaintiff had remained inactive and failed to make inquiry or take measures for self-protection for a period considerably shorter than the period of time involved in the instant case. In *Teeter v. Brown*, supra, the reason for the court's decision is clearly stated in the following quotation from the opinion, beginning on page 509: [110]

“It is probable that the complaint alleges sufficient to show that the respondent has acted fraudulently, but in a case of this character that is not

sufficient. The appellant owed some duty to himself. The law of self-protection may not be written into our statute books, but every man knows it is a part of human nature. Appellant's interest in the claim was initiated in 1901. Almost at once thereafter the alleged fraudulent acts of respondent commenced. Within a short time he took from the mine more than a million dollars, and yet appellant did not learn of these frauds and of these facts until 1919. What active steps did he take during all these years to learn whether he was being defrauded? Apparently none. What did he do to protect his own property rights? Apparently nothing. He knew he had an interest in this property and that he was dealing with a comparative stranger; and yet, for fifteen or eighteen years, he did nothing to learn the condition of the property or its value, or what was being done with it, or who was claiming it. It would seem that the slightest investigation on his part would have led him to facts and circumstances pointing to the fraud alleged and indicating the great value of the mine. It would seem impossible that such a large amount of value could be taken from such a small tract of land without all the public within the vicinity being acquainted with the fact. For fifteen or eighteen years the appellant sat idly by. Meanwhile some of the persons acquainted with the facts have died, and the great lapse of time has dimmed the memory of others. After fifteen years of inaction, he calls upon us. Such a voice does not stir the conscience of a court of

chancery. Ordinarily, equity puts out its assisting arm only to those who have shown a disposition to help themselves.” [111]

Plaintiffs have cited Washington cases on the point that, lapse of time alone is not sufficient to constitute laches—that there must also be shown some disadvantage to the party asserting the defense. The cases are not in point here. In the present case, plaintiffs’ action is based upon an oral contract alleged to have been made in 1913, and they did not commence the action until 1952, eight years after all of the individuals whom they claim acted for the defendant corporation in making the contract had died. The plaintiffs, according to the allegations of their own pleading, did not make a formal written demand upon the defendant for the performance of the oral contract until 1951, many years after the last survivor of defendant’s potential witnesses regarding the oral agreement had passed away. It is difficult to imagine a litigant being put to more serious disadvantage than to be called upon to defend against an eight and one-half million dollar lawsuit based upon a 39-year-old oral contract, when the only witnesses who could possibly testify in behalf of the defendant as to whether or not the contract was actually made, and, if so, as to what were its terms and conditions, have been dead for eight years or more.

In *McKnight v. Basilides*, 19 Wn. 2d 391, 143 P. 2d 307, the Washington State Supreme Court had

occasion to apply the principle above mentioned that, laches does not arise from lapse of time alone, but there must also be involved some intervening change in the condition or relation of the parties adversely affecting the rights of the party sought to be charged. The case is factually distinguishable from the instant one, but it is significant that, in discussing the subject of laches, Judge Simpson, who wrote the court opinion, made the following comment (p. 403):

"The lapse of time did not obscure any evidence in this case. All of the witnesses who could have testified relative to the situation and condition of the property in 1929 were available at the trial of this case, and there is no showing that any material documents were lost or destroyed." [112]

If the Washington 3-year statute of limitations does not apply, recovery is precluded by laches.

Defendant's motion for summary judgment is granted.

/s/ SAM M. DRIVER,  
United States District Judge.

[Endorsed]: Filed August 27, 1956. [113]

[Title of District Court and Cause.]

ORDER GRANTING MOTION FOR  
SUMMARY JUDGMENT

The motion of the defendant, General Electric Company, for a Summary Judgment, pursuant to Rule 56 of the Rules of Civil Procedure, having been presented and the Court being fully advised, and having filed herein its written Memorandum of Opinion, it is now

Ordered that defendants' motion for a Summary Judgment be and the same is hereby granted.

Dated this 30th day of August, 1956.

/s/ SAM M. DRIVER,  
United States District Judge.

Presented by:

/s/ PHILIP S. BROOKE,  
Of Attorneys for General  
Electric Co.

Service of copy acknowledged.

[Endorsed]: Filed August 30, 1956. [114]

United States District Court for the Eastern  
District of Washington, Northern Division

No. 1036

MILTON E. DAM and EVERETT S. DAM, Co-partners Doing Business Under the Firm Name and Style of DAM BROTHERS,

Plaintiffs,

vs.

GENERAL ELECTRIC COMPANY, a Foreign Corporation; AMERICAN POWER & LIGHT COMPANY, a Foreign Corporation, and ELECTRIC BOND & SHARE COMPANY, a Foreign Corporation,

Defendants.

### SUMMARY JUDGMENT

The motion of the defendant, General Electric Company, for a Summary Judgment, pursuant to Rule 56 of the Rules of Civil Procedure, having been presented and the Court being fully advised,

The Court finds that the defendant, General Electric Company, is entitled to a Summary Judgment as a matter of law.

It Is, Therefore, Ordered, Adjudged and Decreed that the said defendants' motion for a Summary Judgment be and the same is hereby granted; that the plaintiffs have and recover nothing by the suit;

and that the defendant, General Electric Company, go hence without day.

Dated this 30th day of August, 1956.

/s/ SAM M. DRIVER,

United States District Judge.

Presented by:

/s/ PHILIP S. BROOKE,

Of Attorneys for General  
Electric Co.

Receipt of copy acknowledged.

[Endorsed]: Filed August 30, 1956. [115]

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[Title of District Court and Cause.]

#### NOTICE OF APPEAL

To: The District Court of the United States for the Eastern District of Washington, Northern Division: Stanley D. Taylor, Clerk thereof, and—

To: General Electric Company, a Foreign Corporation, Defendant-Respondent: and—

To: Hamblen, Gilbert & Brooke, its Attorneys:

You, and each and all of you will please take notice that the above-named plaintiffs, as appellants, do hereby appeal from the above-entitled

Court to the United States Court of Appeals for the Ninth Circuit from the whole of the Summary Judgment rendered and entered by the Court herein, under date of August 30th, 1956, and the plaintiffs-appellants will seek by such appeal to have reviewed all intermediate Orders affecting the plaintiffs-appellants rendered and entered by the Court in the above-entitled cause, including the Order Striking the Plaintiffs' Motion for Adjournment of Hearing on Defendant's Motion for Summary Judgment, dated and filed August 8th, 1956. [116]

You will further take Notice that the above-named plaintiffs, as appellants, have filed herein their Bond on Appeal, as required by Rule 73(c) of the Federal Rules of Civil Procedure.

Dated this 25th day of September, 1956.

PHIPPS & PHIPPS,

/s/ HARVE H. PHIPPS,  
Attorneys for Plaintiffs-  
Appellants.

Affidavit of mail attached.

Service of copy acknowledged.

[Endorsed]: Filed September 26, 1956. [117]

[Title of District Court and Cause.]

### BOND FOR COSTS

Know All Men by These Presents:

That we, Dam Brothers, a partnership consisting of Milton Dam and Everett Dam, as Principal, and the Fidelity and Deposit Company of Maryland as Surety, are held and firmly bound unto General Electric Company, a foreign corporation, its executors, administrators, or assigns, in the sum of Two Hundred Fifty and no/100ths (\$250.00) Dollars, lawful money of the United States of America, to be paid unto the said General Electric Company, a foreign corporation, its executors, administrators, or assigns, to which payment well and truly to be made, we do bind and oblige our heirs, executors, and administrators, jointly and severally by these presents.

Sealed with our seals and dated this 13th day of September, 1956.

Whereas, the above-named Dam Brothers, as plaintiffs heretofore citizens of the State of Washington, commenced an action in the United States District Court, in and for the Eastern District of Washington, Northern Division, against the said defendants.

Now Therefore, the Condition of This Obligation Is Such, That if the above-named Dam Brothers, appellants to the Circuit Court of Appeals, Ninth Circuit, in the said action shall pay on demand, all

costs that may be adjudged, or awarded against them as aforesaid in said action; then this obligation shall be void, otherwise the same shall be and remain in full force and virtue.

Signed and sealed this 13th day of September, 1956.

DAM BROTHERS,  
a Co-partnership;

By /s/ HARVE H. PHIPPS,  
Attorney.

[Seal] FIDELITY AND DEPOSIT COMPANY  
OF MARYLAND,

By /s/ A. B. KALIN,  
Attorney-in-Fact.

Approved Sept. 27, 1956.

/s/ SAM M. DRIVER,  
U. S. District Judge.

[Endorsed]: Filed September 26, 1956. [124]

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[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR FILING  
RECORD AND DOCKETING APPEAL

It Appearing to the Court from the records and files herein, and on application of the plaintiffs, that it is necessary that the time for filing the record on appeal and docketing such appeal in the

office of the Clerk of the United States Court of Appeals, Ninth Circuit, be enlarged and extended as herein provided,

It Is Ordered that under the provisions of Rule 73(g) of the Federal Rules of Civil Procedure, the time for filing the record on appeal and for docketing such appeal in the office of the Clerk of the United States Court of Appeals, Ninth Circuit, be and is hereby enlarged and extended to December 20th, 1956.

Dated and done at Spokane, in the Eastern District, Northern Division, of the District Court of the United States, this 22nd day of October, 1956.

/s/ SAM M. DRIVER,  
Judge of District Court.

Presented by:

/s/ HARVE H. PHIPPS,  
Attorney for Plaintiffs.

[Endorsed]: Filed October 22, 1956. [125]

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[Title of District Court and Cause.]

#### STIPULATION

It Is Hereby Stipulated and Agreed, by and between the parties to the above-entitled action through their respective Attorneys, as follows: Phipps & Phipps, by Harve H. Phipps, Sr., as Attorneys for the plaintiffs, and Hamblen, Gilbert &

Brooke, by Philip S. Brooke, and Cooley, Crowley, Gaither, Godward, Castro & Huddleson, by William W. Godward, as Attorneys for the defendant General Electric Company, a Corporation, as follows:

1. That on the presentation of this Stipulation to the Judge of the above-entitled Court, the Court may make and enter its Order, under Rule 73 (g) of the Federal Rules of Civil Procedure, enlarging and extending the time for filing the record on Appeal and docketing the Appeal in the Office of the Clerk of the United States Court of Appeals, Ninth Circuit, to and including the 20th day of December, 1956, and,
2. That on the presentation of this Stipulation to the Judge of the above-entitled Court, the Court may make and enter its Order directing, authorizing and permitting the Clerk of the above-entitled Court to accept for filing and file in his Office as a part of the record in this case, an Amendment to the Statement of Points to Be Relied Upon on Appeal filed by plaintiffs under date of [126] September 25, 1956, and particularly that portion thereof designated "Point No. 6," by which amendment said Point No. 6 is amended to read in full as follows:

"Point No. 6

"Whereas, the trial Court in its Opinion on which it bases its decision in this case has taken judicial notice of the fact that since the commencement of this action there has been organized the

It Is Hereby Ordered that the Clerk of the above-entitled court be and he is hereby directed to accept for filing and to file in his office as a part of the record in this case, the following Amendment to the Statement of Points to Be Relied Upon on Appeal filed by the plaintiffs under date of September 25th, 1956, and particularly that portion thereof designated "Point No. 6," by which amendment said Point No. 6 is amended to read in full as follows:

"Point No. 6

"Whereas, the trial Court in its Opinion on which it bases its decision in this case has taken judicial notice of the fact that since the commencement of this action there has been organized the Grant County Public Utility District which has obtained a license to survey the Priest Rapids site for the purpose of construcing [129] a Dam or Power Site at Priest Rapids, the trial Court wholly fails to take judicial notice, also a matter of public record, that since the commencement of this action the defendant General Electric Company, through one of its Subsidiary Companies, has sold and transferred the fifty-five thousand (55,000) acres of Railroad Grant lands, and Power Sites, Townsites, Industrial Sites and Terminal sites lands acquired through the efforts of the plaintiffs, Dam Brothers, in their performance of the Joint Venture Agreement, and has distributed to the plaintiffs a portion of the proceeds derived from such sales, clearly indicating that the defendant held this land in trust,

under the Joint Venture Agreement, and recognizing rights in the plaintiffs under such joint venture agreement."

It Is Further Ordered that this order is made and based upon the Stipulation of the parties dated October 24th, 1956, and filed herein, in which Stipulation the General Electric Company reserves the right to question (a) the relevancy, materiality or correctness of any of the matters set forth in said stipulation or any part thereof, or (b) the right of the plaintiffs to so amend said Statement of Points to Be Relied Upon on Appeal or any part thereof or the power of the Court to permit any amendment thereto or any part thereof, and further reserving the right upon said amendment being filed to file any pleading in opposition thereto in answer or objection, including a motion to strike, which it may deem appropriate.

Dated and done at Spokane, in the Northern Division of [130] the Eastern District of Washington, this 31st day of October, 1956.

/s/ SAM M. DRIVER,

Judge of the Above-Entitled  
Court.

Presented by:

/s/ HARVE H. PHIPPS,  
Attorney for Plaintiffs-  
Appellants.

[Endorsed]: Filed October 31, 1956. [131]

[Title of District Court and Cause.]

AMENDMENT TO POINT No. 6 OF  
STATEMENT OF POINTS ON APPEAL

Pursuant to the Stipulation of the parties dated October 24th, 1956, filed herein, and the Order of the above-entitled court entered thereon, dated and filed October 31st, 1956, Point No. 6 of the plaintiffs-appellant's Statement of Points to Be Relied Upon on Appeal, filed herein under date of September 25th, 1956, is hereby amended to read as follows:

“Point No. 6

“Whereas, the trial court in its Opinion on which it bases its decision in this case has taken judicial notice of the fact that since the commencement of this action there has been organized the Grant County Public Utility District which has obtained a license to survey the Priest Rapids Site for the purpose of constructing a Dam or Power Site at Priest Rapids, the trial Court wholly fails to take judicial notice, also a matter of public record, that since the commencement of this action the defendant General Electric Company, through one of its subsidiary companies, has sold and transferred the fifty-five thousand (55,000) acres of Railroad Grant Lands and Power Sites, Townsites, Industrial Sites and [132] Terminal Site Lands acquired through the efforts of the plaintiffs, Dam Brothers, in their performance of the Joint Venture Agreement, and has distributed to the plaintiffs a portion of the

proceeds derived from such sales, clearly indicating that the defendant held this land in trust under the Joint Venture Agreement, and recognizing rights in the plaintiffs under such Joint Venture Agreement."

Dated this 5th day of November, 1956.

PHIPPS & PHIPPS,

By /s/ HARVE H. PHIPPS,

Attorneys for Plaintiffs-  
Appellants.

Service of copy acknowledged.

[Endorsed]: Filed November 5, 1956. [133]

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[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,  
Eastern District of Washington—ss.

I, Stanley D. Taylor, Clerk of the United States District Court for the Eastern District of Washington, do hereby certify that the documents annexed hereto are the originals filed in the above-entitled cause:

Second Amended Complaint, filed 11/5/53.

Order quashing service and dismissing as to Electric Bond and Share Co., filed 11/21/52.

Order quashing service and dismissing as to American Power and Light Co., filed 4/9/53.

Motion to make Second Amended Complaint more definite and certain, filed 8/25/55.

Motion to Strike, filed 8/25/55.

Motion to Dismiss, filed 8/25/55.

Affidavit of Milton E. Dam, filed 9/2/55.

Copy, Letter of Judge Driver, dated 9/14/55.

Order granting in part motions to strike and for more definite statement, filed 9/14/55.

Consent to inserting and deleting certain matters in Plaintiffs' Second Amended Complain, filed 9/28/55.

Consent to inserting and deleting certain matters in Plaintiffs' Second Amended Complaint, filed 9/30/55.

Motion to Dismiss, filed 10/7/55.

Affidavits of Ray H. Luebbe, B. H. Kizer and Philip S. Brooke, and Certificate of Earle Coe of October 11, 1955, filed 10/14/55.

Affidavit of Milton E. Dam, filed 11/2/55.

Affidavit of John W. Bremer, filed 11/10/55.

Copy, Letter of Judge Driver, dated 1/3/56.

Affidavit of Milton E. Dam, filed 3/12/56.

Copy, Letter of Judge Driver, dated 3/20/56.

Order denying motion to dismiss of General Electric Co., filed 5/29/56.

Copy, Letter of Judge Driver, dated 5/29/56.

Stipulation extending time to answer Second Amended Complaint, filed 6/11/56.

Order extending time to answer Second Amended Complaint, filed 6/12/56.

Answer of Defendant General Electric Co., filed 7/10/56.

Affidavit of William J. Durka and attached exhibits, filed 7/10/56.

Motion for Summary Judgment, filed 7/10/56.

Motion for adjournment of hearing on Motion for Summary Judgment with attached affidavit, filed 7/31/56.

Order striking motion for adjournment of hearing on Summary Judgment motion, filed 8/8/56.

Copy, Letter of Judge Driver, dated 8/8/56.

Opinion of the Court, filed 8/27/56.

Order granting motion for Summary Judgment, filed 8/30/56.

Summary Judgment, filed 8/30/56.

Notice of Appeal, filed 9/26/56.

Statement of Points to Be Relied Upon on Appeal, filed 9/26/56.

Bond for Costs on Appeal, filed 9/26/56.

Order extending time for filing record and docketing appeal, filed 10/22/56.

Stipulation, filed 10/30/56.

Order amending and supplementing Statement of Points to Be Relied Upon on Appeal, filed 10/31/56.

Amendment to Point No. 6 of Statement of Points on Appeal, filed 11/5/56.

Designation of Contents of Record on Appeal, filed 9/26/56.

Defendant-Appellee's Designation of Contents of Record on Appeal, filed 10/2/56.

and that the same constitute the record for hearing of the appeal from the judgment of the United States District Court Court for the Eastern District

of Washington, in the United States Court of Appeals for the Ninth Circuit, as called for in Appellants' Designation of Contents of Record on Appeal, and Defendant-Appellee's Designation of Contents of Record on Appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at Spokane in said District this 12th day of December, A.D. 1956.

[Seal] /s/ STANLEY D. TAYLOR,  
Clerk, U. S. District Court, Eastern District of  
Washington.

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[Title of District Court and Cause.]

SUPPLEMENTAL CERTIFICATE OF CLERK  
United States of America,  
Eastern District of Washington—ss.

I, Stanley D. Taylor, Clerk of the United States District Court for the Eastern District of Washington, do hereby certify that the documents annexed hereto are the originals filed in the above-entitled cause:

Complaint.

Summons, General Electric Company.

Motion to Dismiss, American Power & Light Company.

Motion to Dismiss, Electric Bond and Share Company.

Amended Complaint.

Motion to Dismiss Amended Complaint, American Power & Light Co.

Court Reporter's Transcript of Hearing on November 17, 1952, on Motions to Dismiss.

Court Reporter's Transcript of Hearing on September 7, 1955, on Motion to Dismiss.

Opinion of the Court re Motion to Quash Service as to American Power and Light Company.

Notice of Hearing on Motion for leave to serve and file Second Amended Complaint.

Order on Motion for leave to serve and file Second Amended Complaint.

Defendant-Appellee's Supplemental Designation of Contents of Record on Appeal.

and that the same constitute the supplemental record for hearing of the appeal from the judgment of the United States District Court for the Eastern District of Washington, in the United States Court of Appeals for the Ninth Circuit, as called for in Defendant-Appellee's Supplemental Designation of Contents of Record on Appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at Spokane in said District this 27th day of February, A.D. 1957.

[Seal] /s/ STANLEY D. TAYLOR,  
Clerk, U. S. District Court, Eastern District of Washington.

[Endorsed]: No. 15395. United States Court of Appeals for the Ninth Circuit. Milton E. Dam and Everett S. Dam, Co-partners Doing Business Under the Firm Name and Style of Dam Brothers, Appellants, vs. General Electric Company a Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Eastern District of Washington, Northern Division.

Filed December 14, 1956.

Docketed December 24, 1956.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

United States Court of Appeals  
for the Ninth Circuit  
No. 15395

MILTON E. DAM and EVERETT S. DAM, Co-partners Doing Business Under the Firm Name and Style of DAM BROTHERS,

Plaintiffs-Appellants,

vs.

GENERAL ELECTRIC COMPANY, a Foreign Corporation; AMERICAN POWER & LIGHT COMPANY, a Foreign Corporation, and ELECTRIC BOND & SHARE COMPANY, a Foreign Corporation,

Defendants-Respondents.

**STATEMENT OF POINTS APPELLANT  
WILL RELY UPON ON APPEAL**

The above-entitled cause having been docketed in the above court on the Plaintiffs'-Appellants' appeal from the District Court of the United States for the Eastern District of Washington, Northern Division, and the appellants having designated the parts of the record they desire incorporated in record on appeal, which is less than the entire record, the appellants submit herewith a Statement of the Points on Which They Intend to Rely on Appeal, to wit:

Point No. I.

Under date of November 5th, 1953, on application of the appellants, they were permitted to serve

and file their Second Amended Complaint herein, and on or about the 25th day of November, 1953, the defendant General Electric Company served and filed motions directed against said Second Amended Complaint, under Rule 12 of the Federal Rules of Civil Procedure, (1) to dismiss, (2) to make the Second Amended Complaint more definite and certain, and (3) to strike parts of said Second Amended Complaint. The defendant-respondent based its claim for dismissal was that the Second Amended Complaint did not state a claim against the defendant on which relief can be granted. The third ground was that the claims asserted therein are void under the Statute of Frauds. The fourth ground was that the claims asserted therein are barred by the Statute of Limitations, and the fifth ground was that the claims asserted therein are barred by reason of Laches on the part of the plaintiffs-appellants.

Under date of May 29th, 1956, the Court rendered and entered its Order "that the Motion of the defendant, General Electric Company to dismiss plaintiffs' Second Amended Complaint is hereby denied, and that the said defendant is allowed twenty days from and after the date of this order in which to answer plaintiffs' Second Amended Complaint," such order being based in part on the determination by the court that under Rule 8(c) of the Federal Rules of Civil Procedure, the defenses of Statute of Frauds, Statute of Limitations, and Laches, must be asserted by way of affirmative defenses in an

answer and cannot be determined by Motion to Dismiss.

Thereafter the defendant General Electric Company served and filed its Answer, setting up as its Fourth and Fifth Affirmative Defenses the statute of frauds, statute of limitations and laches, and in connection with and at the time of such service the defendant served its Motion for Summary Judgment under Rule 56(b) and (c), Federal Rules of Civil Procedure.

Upon the service of such answer, with its affirmative defenses, and the Motion for Summary Judgment, the plaintiffs, under date of July 20th, 1956, served and filed their Motion for Adjournment of Hearing on the Motion for Summary Judgment until the trial of the action under the issues of fact "for the reason and upon the grounds that there are genuine issues of material facts in this case and because of such issues the Court cannot determine, as a matter of law, that the defendant is entitled to Summary Judgment under said Rule 56."

Under date of August 8th, 1956, the Judge of the District Court, on its own motion entered its order, reading, in part, as follows:

"Now, therefore, plaintiffs' Motion for Adjournment of Hearing on Summary Judgment Motion is ordered stricken, and the Clerk of this Court is directed to strike the same from the files in the above-entitled cause."

Under date of August 27th, 1956, without any further hearing or argument, and without any evidence to support the Fourth Affirmative Defense of the statute of limitations, or the Fifth Affirmative Defense of laches, the trial judge filed its opinion on the motion of the defendant General Electric Company for Summary Judgment and concluded that if the Washington 3-year statute of limitations does not apply, recovery is precluded by laches, and under date of August 29th, 1956, rendered and entered its Order for Summary Judgment, and thereafter rendered and entered its Summary Judgment in favor of the defendant, General Electric Company, from which this appeal is taken.

That the act and actions of the trial Court in summarily and of its own motion refusing to hear or entertain plaintiffs' motion to adjourn the hearing on defendant's motion for Summary Judgment until the trial of the cause upon the issues of fact raised by the pleadings, and particularly under the Fourth and Fifth Affirmative Defenses, and in deciding, without factual support, that Laches applied, or that the statute of limitations had run, has resulted in the abrogation of the Rules applicable to said Court, and particularly Rule 1 of the Federal Rules of Civil Procedure which required the Rules to be construed to secure the just, speedy and inexpensive determination of this action, and as the direct and proximate result of the arbitrary action of the trial Court in summarily and without factual support, finding and determining that plain-

tiffs' Motion to adjourn the hearing on defendant's Motion for Summary Judgment be ordered stricken, and directing the Clerk to strike the same from the files, this appeal has been made necessary, with the resulting delay, expense, and injustice, and to the great prejudice of the plaintiffs-appellants.

### Point No. II.

That under the issues raised by the Second Amended Complaint, and which under well-established rules of law and procedure the trial court in determining the Motion to Dismiss or for Summary Judgment must accept as true, and which the trial court did accept as true, as indicated by its Opinion, dated August 27th, 1956, this action is based on a contract, or at least upon an implied, constructive or quasi-contract entered into between the parties to this action, under which the plaintiffs-appellants performed everything required to be performed by them, and as the result of the performance of such contract by the plaintiffs, the defendant has reaped vast benefits, without in any way compensating the plaintiffs-appellants for the results achieved and the benefits reaped by the defendant, whether the relationship of the parties be determined to be that of joint adventurers, partners, constructive or quasi-partners, or some other designation, the relationship created demanded the highest degree of fidelity and loyalty on the part of each and all of the parties, as to such undertaking, and the doctrine of uberrima fides applies to each of the parties to the fullest extent, and the relationship is not ter-

minated prior to the attainment of the objective sought, except by mutual consent, and is not and cannot be terminated by the act, actions or failure of one of the parties, and the statute of limitations or laches does not commence to run until there has been a breach of faith on the part of one of the parties, and until full compensation has been made to the parties performing under the agreement for the benefits received or the unjust enrichment and advantages obtained as the result of such performance by the plaintiffs-appellants.

The decision and determination of the trial court, summarily and without any evidence, and contrary to the facts which the plaintiffs-appellants are, and will be able to produce and establish, determining that the plaintiffs-appellants cause of action is barred by laches and limitation is arbitrary, unjust, inequitable and contrary to principles of justice and equity.

### Point No. III.

Neither laches nor the statute of limitations commences to run until the cause of action accrues and the plaintiffs' rights have ripened into a right to sue, and under the pleadings and the facts in this case, neither laches nor the statute of limitations had run against the plaintiffs' claims at the time of the commencement of this action.

### Point No. IV.

Neither laches nor the statute of limitations operates in favor of one who has unjustly enriched himself or itself as the result of performance on the

part of the other, and it is unjust and inequitable on the part of the court to summarily grant judgment to the defendant General Electric Company which has been unjustly enriched by the performance of their contractual obligations on the part of the plaintiffs-appellants.

#### Point No. V.

There are no allegations in the pleadings, nor in the affidavits submitted to the court on defendants' Motion for Summary Judgment from which it can be fixed or determined that the defendant General Electric Company repudiated or abrogated the joint venture agreement and so notified the plaintiffs, nor any basis for determining any time, prior to the commencement of this action, that it was not the purpose and intention of the defendant to complete and comply with the obligations assumed by it under the joint venture agreement, and it was sheer surmise or conjecture on the part of the trial court in its determination that the defendant General Electric Company had been prejudiced by the delay of the plaintiffs-appellants in bringing this action.

#### Point No. VI.

Whereas, the trial court in its Opinion on which it bases its decision in this case has taken judicial notice of the fact that since the commencement of this action there has been organized the Grant County Public Utility District which has obtained a license to survey the Priest Rapids site for the purpose of constructing a dam or power site at

Priest Rapids, the trial court wholly fails to take judicial notice, also a matter of public record, that since the commencement of this action the defendant General Electric Company, through one of its subsidiary companies, has sold and transferred the fifty-five thousand (55,000) acres of Railroad Grant Lands, and power sites, townsites, industrial sites and terminal site lands acquired through the efforts of the plaintiffs-appellants, Dam Brothers, in the performance of the joint venture agreement, and has distributed to the plaintiffs a portion of the proceeds derived from such sales, clearly indicating that the defendant held this land in trust under the joint venture agreement, and recognizing rights of the plaintiffs under such joint venture agreement.

Dated December 26th, 1956.

PHIPPS & PHIPPS,  
By /s/ HARVE H. PHIPPS,  
Attorneys for Plaintiffs-  
Appellants.

Receipt of copy acknowledged.

[Endorsed]: Filed January 2, 1957.

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[Title of Court of Appeals and Cause.]

**STIPULATION REGARDING SUPPLEMENTAL DESIGNATION OF CONTENTS OF RECORD ON APPEAL**

It Is Hereby Stipulated by and between the parties to the above-entitled action through their re-

spective counsel that the foregoing Supplemental Designation of Contents of Record on Appeal may be filed and the Clerk is hereby authorized and requested to certify a supplemental record on appeal containing the matters listed in the foregoing supplemental designation and to transmit the same to the United States Court of Appeals for the Ninth Circuit.

It is understood and agreed that in signing this stipulation the plaintiffs do not admit the relevancy or materiality of any of the supplemental data covered by the stipulation, and reserve the right to, at any time, object to all or any part thereof, and that any additional costs or expense entailed by this supplemental addition to the record shall be borne by the defendant.

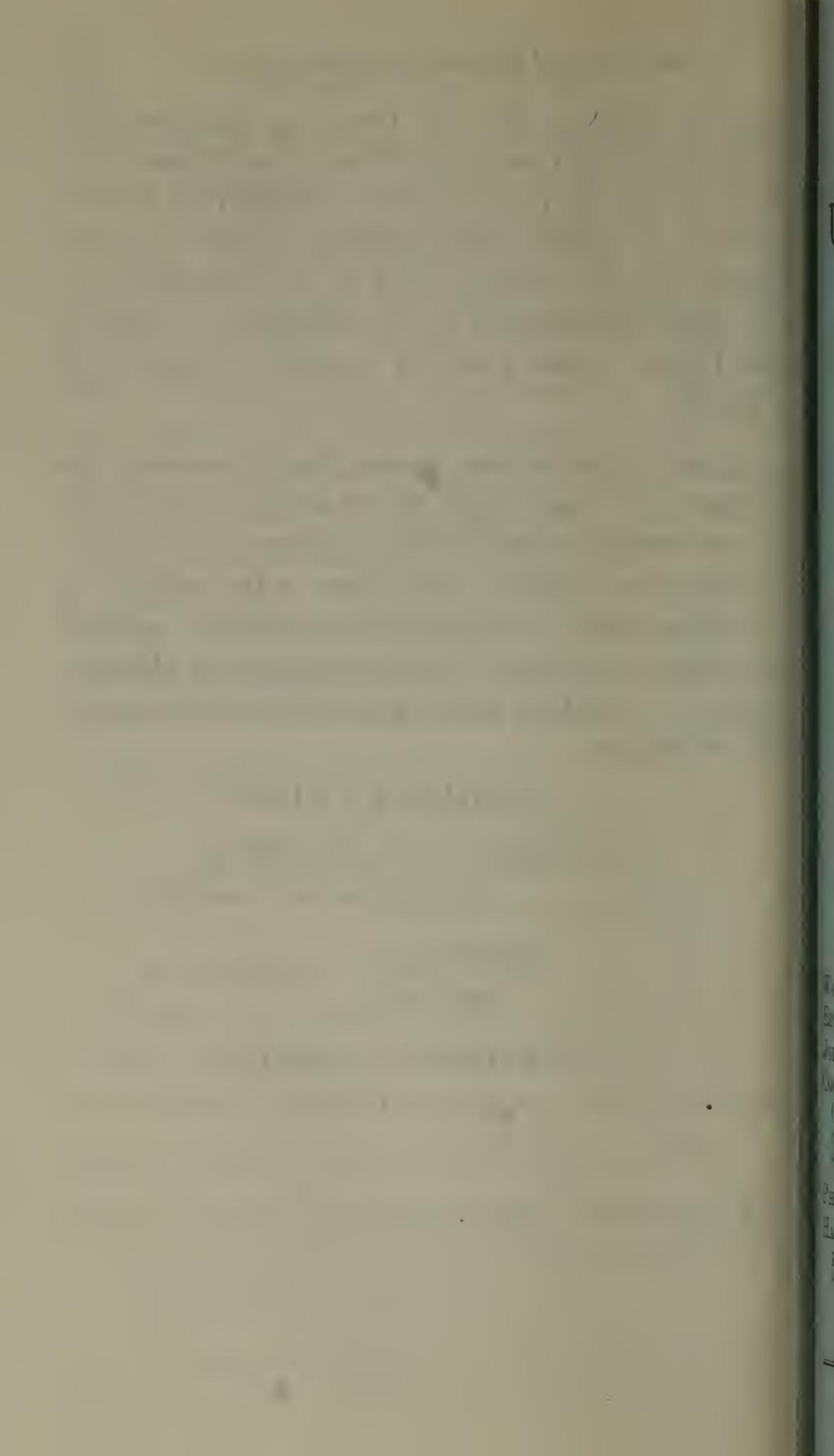
PHIPPS & PHIPPS,

By /s/ HARVE H. PHIPPS,  
Attorneys for Plaintiffs.

HAMBLEN, GILBERT &  
BROOKE,

By /s/ PHILIP S. BROOKE,  
Attorneys for Defendant, General Electric Company.

[Endorsed]: Filed February 15, 1957.



No. 15,395

In the

# United States Court of Appeals

*For the Ninth Circuit*

---

MILTON E. DAM and EVERETT S. DAM, Co-partners doing business under the Firm Name and Style of DAM BROTHERS,  
Appellants,

vs.

GENERAL ELECTRIC COMPANY,  
a corporation,

Appellee.

---

## Brief for Appellee

Appeal from the United States District Court for the Eastern District of Washington, Northern Division

---

WILLIAM W. GODWARD  
EDWIN E. HUDDLESON, JR.  
JOHN H. WALLACE  
COOLEY, CROWLEY, GAITHER,  
GODWARD, CASTRO & HUDDLESON,  
333 Montgomery Street,  
San Francisco 4, California,

PHILIP S. BROOKE  
HAMBLEN, GILBERT & BROOKE  
Paulsen Building  
Spokane 1, Washington  
*Attorneys for Appellee.*

FILED

JUL 10 1957

PAUL P. O'BRIEN, CLERK



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No. 15395

In the

# United States Court of Appeals *For the Ninth Circuit*

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MILTON E. DAM and EVERETT S. DAM, Co-partners doing business under the Firm Name and Style of DAM BROTHERS,  
*Appellants,*  
vs.  
GENERAL ELECTRIC COMPANY,  
a corporation,  
*Appellee.*

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## Brief for Appellee

Appeal from the United States District Court for the Eastern District of Washington, Northern Division

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### I.

#### STATEMENT OF THE CASE

##### A. Nature of the Action.

This action was commenced in the District Court in 1952 and is based upon an alleged oral contract made in 1913 between plaintiffs-appellants and defendant-appellee General Electric Company.\* The first cause of action is for

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\*Plaintiffs-appellants and defendant-appellee are hereinafter designated as plaintiffs and defendant, respectively.

damages for breach of such oral contract. The second cause of action (in the alternative) is a claim for the unjust enrichment of defendant resulting from the alleged performance by plaintiffs under such oral contract.

### **B. The Ruling of the District Court.**

The District Court granted defendant's motion for summary judgment on the grounds that both causes of action were barred (a) by the three-year statute of limitations as applied in the State of Washington and (b) by the doctrine of laches as it has been applied in the State of Washington. Summary judgment thereafter was entered. This appeal was taken by plaintiffs from such judgment.

### **C. The Issue Before This Court.**

The issue before the Court is whether the District Court could properly grant defendant's motion for summary judgment where:

1. The oral contract allegedly made with defendant in 1913 was admitted<sup>1</sup> for the purpose of the motion and not otherwise.
2. Defendant, in support of its motion, presented evidence which of itself established that (a) defendant to the knowledge of plaintiffs never performed such oral contract and, many years before the commencement of the action, made clear by its acts and conduct that its part of such contract would not be performed, and (b) all individuals who acted for defendant in making such alleged oral contract had died eight years or more before the commencement of the action.

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1. It is and has been defendant's position (except for the purposes of the motion for summary judgment) that General Electric Company was never a party to any such oral contract.

3. Plaintiffs, in opposition to the motion, (a) did not specify any evidence which could be adduced to change the result of such material facts but (b) relied solely upon general allegations in an amended complaint of assurances of performance by defendant and reliance thereon by plaintiffs.

4. The record contains no basis for concluding that any evidence could be adduced to change the result of such material facts.

## II.

### **PROCEEDINGS IN THE DISTRICT COURT**

#### **A. Introduction.**

In passing upon defendant's motion for summary judgment the District Court, as required by Rule 56, considered "all the relevant material" in the file of the case (R. 237) to determine whether there was a genuine issue as to any fact material to the defenses of limitations and laches. For this reason, and so that this Court may have the same perspective as the District Court, the full record on appeal is hereinafter summarized.

#### **B. Summary of Proceedings.**

The proceedings are summarized chronologically as listed below. The numbers opposite each item refer to pages of this brief.

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#### **1. ORIGINAL COMPLAINT.**

The action was commenced on July 16, 1952, by the filing of a **verified**<sup>2</sup> complaint containing eighty-seven numbered paragraphs of detailed allegations (R. 3 to 44). Named as defendants were General Electric Company, a New York corporation, Electric Bond and Share Company, a New York corporation, and American Power & Light Company, a Maine corporation. Electric Bond and Share Company was alleged to have been wholly owned by General Electric Company until "soon after 1925" when General Electric Company distributed among its stockholders the Electric Bond and Share common stock (R. 8). American Power & Light Company, in turn, was alleged to have been organized by Electric Bond and Share Company and "until November 1935" wholly under Electric Bond and Share Company's domination (R. 9).

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2. Under Rule 56(c), the Court could properly consider the verified complaint along with the affidavits of plaintiffs in determining whether allegations in the unverified amended complaints were intended to tender genuine issues of fact or were formal only.

Pleadings in the Federal Court need not be verified, of course, under Rule 11.

American Power & Light Company was also described as the owner of "all the common stock of its dummy holding company the Washington Irrigation & Development Company, a Washington Company" (R. 4).

A summary<sup>3</sup> of the verified complaint follows:

Plaintiff, "during the 1890's" became interested in irrigation and land development on the Columbia River at Priest Rapids. By 1913 they had acquired control of a large acreage of irrigable land; organized a Priest Rapids Land Owners' Association; accomplished favorable changes in Washington laws; obtained appropriations for geological work; undertaken and paid for engineering and other investigations; worked out a transportation and communications system; interested persons who were ready to colonize the lands and contractors who were ready to accept Priest Rapids Highland Irrigation District bonds for construction of a proposed project; and acquired full confidence and the moral support of land owners and government authorities (R. 5 to 7).

About 1910 the "General Electric Company's subholding and subsidiaries" made their first investments at Priest Rapids (R. 10).

During this period, Mr. Sidney Z. Mitchell, president of **Electric Bond and Share Company**, "100% owned by the General Electric Company" (R. 12), became concerned about the Dam Brothers and their Priest Rapids interests for these reasons: the Dam Brothers' plans did not require

3. It is difficult to summarize this pleading, not only because of its great length and failure to follow a chronological development, but also because of the uncertain and vague allegations regarding the relationship of the defendants to each other and to the plaintiffs. For these reasons, as well as for emphasis, many allegations or portions thereof are quoted verbatim.

Heavy black type, whether or not in quoted material, means that the emphasis is ours.

Federal approval; the Dam Brothers' plan would interfere with the plans of "General Electric-Electric Bond and Share" to develop a single high dam; "General Electric-Electric Bond and Share" had only partial power site lands; and, the "power people" could not obtain a change in objectionable water power laws (R. 12-13).

"Mr. Mitchell" consequently made overtures to the Dam Brothers which resulted in their accepting his invitation to go to New York for consultation, and in April, 1913, "a joint adventure was formed with **Electric Bond and Share Company** at their offices \* \* \* for the development of a greater Priest Rapids project" (R. 13).

As their part of the "joint venture agreement" the Dam Brothers agreed to do the following:

Abandon their plans and join with the "General Electric-Electric Bond substitute plans" for development of the rapids; make available the results of their previous investigations; help obtain additional power site and industrial lands to be turned over to "the **Electric Bond and Share Company**, which would build the dam. With a Priest Rapids Power Company organized and incorporated by them when the federal legislation for a power bill was passed"; acquire jointly with "**Electric Bond & Share Company**" about 55,000 acres which were a part of the Dam Brothers' original Priest Rapids project plans, and "help obtain passage of a Federal Water Power Bill in Congress to permit **Electric Bond & Share** to build a dam at Priest Rapids \* \* \*" (R. 14, 15).

The "commitments of the General Electric-Electric Bond & Share interests" included the following:

Dam Brothers were to receive \$500,000 of the common stock of the **Priest Rapids Power Company** which would be incorporated "when the water power bill passed Congress"; to own a "large percentage" of the land holding syndicate to

be formed at once, "with the syndicate to be limited to and comprise the Dam Brothers, the **Electric Bond & Share Company**, with a few of their officials who would help in the Priest Rapids work"; to have a ten per cent interest in the "**Townsite-Terminal Company**, to include industrial, business, residential and terminal property company operations. **The operating companies to be incorporated when the power company was formed**"; to receive the same division of ten per cent interest in various other syndicates and companies to be organized; "Defendants" would furnish the funds for the various activities and expenses, and "with the passage by the United States Congress of the Water Power Bill, the **Electric Bond & Share Company** would at once start all the activities at Priest Rapids" (R. 16, 17).

At this time, "Mr. Mitchell represented that the great General Electric Company was the largest electrical equipment manufacturing concern in the world; that they owned Electric Bond & Share Company, and were behind its development plans. That Mr. Charles A. Coffin, then chairman of the Board of Directors of General Electric, was anxious to see Priest Rapids developed, which was later confirmed by the then president of said corporation" (R. 16.)

During these New York conferences, "in April 1913" a land syndicate was formed, with the understanding that when this ownership of the land had served its purpose and "upon passage of the bill" **Electric Bond & Share** interests would release their unit control position of the land syndicate giving full management of the lands to the Dam Brothers (R. 20). The actual purchase of the land was then carried out by the syndicate "immediately following the conclusion of the April, 1913, conference and formation of the joint adventure agreement between **Electric**

**Bond & Share and Dam Brothers \* \* \***" (R. 20). A portion of these lands, at the suggestion of the Dam Brothers, was transferred from the syndicate to the Washington Irrigation & Development Company and "have since then been held and are still a part of the assets of the said power site holding company \* \* \*. And constitute one of the claims by the partners, Dam Brothers, against the said defendants as part of the **April, 1913**, partnership agreement" (R. 21-22).

In 1916 the Columbia Highlands Company was incorporated "and the syndicate transferred title of the **entire** land holdings to the new land holding corporation-syndicate." The capital stock of the corporation was distributed to the parties in proportion to their respective interests in the land syndicate (R. 28).

Plaintiffs also "invited attention to **Electric Bond & Share**" to the existence of a mineral "‘Tufa’", a form of natural cement near the head of Priest Rapids available for construction without transportation costs (R. 22). This deposit of Tufa was held by "the Washington Irrigation & Development Company continually up to about the year 1949" (R. 37, 38). It was to have been transferred to a Tufa Natural Cement Company development organization "when the water power bill was passed and the power company formed to build the dam at Priest Rapids" (R. 22).

During the New York visits by plaintiffs, the president of American Power & Light Company and Mr. Edwin W. Rice, president of General Electric Company, both "**expressed interest**" in the Tufa (R. 22, 23).

Immediately after **April 1913** plaintiffs started on the agreed work to help secure federal legislation for a dam at Priest Rapids. A delay of seven years occurred in securing this legislation, and this delay was "caused by General Electric-Electric Bond & Share changing the agreed plans

for a water power bill which could have been passed in Congress within two sessions, without the knowledge or consent of Dam Brothers and constituted a breach of their agreement with plaintiffs, \* \* \*” (R. 24).

With the passage of the water power bill in “**March 1920**” and the formation of the Federal Power Commission, an application was filed for the permit for the dam “by the General Electric-Electric Bond & Share interests in the name of the said Washington Irrigation & Development Company” (R. 26).

At this time, “**during 1920 and 1921**,” the “**partners of Dam Brothers** committed acts of conspiracy, conniving and misrepresentation, by undertaking secretly to dispose of the entire land holdings of approximately 50,000 Acres owned by the General Electric-Electric Bond Share interests-Dam Brothers land holding syndicate-company, without the knowledge, counsel or consideration of their partner-associates Dam Brothers. In complete violation of the 1913 Joint Adventure Agreement, **thus constituting a major breach of contract.**” This “secret land sale was blocked by the Dam Brothers and the said transaction was then dropped by the Defendants” (R. 26, 27).

On **March 3, 1921**, the permit was issued and “the power holding company” undertook the diamond drilling of the dam foundations and “**Electric Bond & Share Company** proceeded to complete the engineering work and plans in its own engineering offices \* \* \* so that a contract could be awarded for the construction of the said dam” (R. 29). In **June 1922** “Mr. Mitchell recommitted the General Electric-Electric Bond and Share commitments, and others added due to Defendants’ desire for new and added help from Dam Brothers” (R. 30). The Dam Brothers because of the “**recent land sale conspiracy by Defendants**” believed that they

"should acquire the syndicate land holdings in order to protect the irrigation project as well as their interests at Priest Rapids" (R. 30). A cash down payment of a considerable sum was made to Mr. Mitchell personally on a Land Purchase Agreement after "**the positive assurance of Mr. Mitchell that General Electric-Electric Bond were ready to get started right away for letting the construction contract for the dam at Priest Rapids**" (R. 30, 31). Nominal payments were made by Dam Brothers to defendants to cover county taxes and corporate expenses of the syndicate company between 1923 and 1926 (R. 34).

The license for the dam was issued on **March 25, 1925**.

At all times "the Dam Brothers fulfilled every pledge, duty and obligation that they were committed to by the Joint Venture agreement with General Electric-Electric Bond and Share." The "General Electric-Electric Bond and Share," however, "**failed to fulfill any of their commitments to Dam Brothers during the periods mentioned in the complaint, covered by the Joint Adventure agreement made April, 1913, and additional commitments made by the Defendants following the first agreement with Plaintiffs**" (R. 39).

It was clear also from the prayer that followed that the "defendants" had never carried out "**any of their commitments to Dam Brothers.**"

The **verified** complaint did **not** allege **any facts** occurring in the **twenty-seven year period** from March, 1925, when the license for the dam was issued, to the commencement of the action, which would make inapplicable accepted rules on accrual of causes of action, limitations and laches.

These twenty-seven years of prosperity, depression, war and peace were covered by these allegations:

## LXX.

"That the country was in the middle of a ten year electrical boom and industrial prosperity, with the demand for large blocks of hydro-electric power resulting in new power construction and installation all over the United States." (R. 34)

## LXXI.

"That everything envisioned by Mr. Charles A. Coffin, head of the great General Electric Company, as pictured to Dam Brothers during the April, 1913, New York conferences, about hydro-electric development, new and wonderful uses for electricity, the enormous prospective demand for electrical equipment and products manufactured by General Electric Company, if favorable water power legislation could be secured, all came to pass. And more too, in the way of electro-metallurgical and electro-chemical demands for hydro-electric power and anxious to go to Priest Rapids. Yet, the world's leading electrical interests failed to start construction of the dam at Priest Rapids upon receiving the License from the Government." (R. 34-35)

## LXXII.

"That defendants could have easily financed and constructed said dam, as there were large power users and customers anxious for large blocks of industrial power far exceeding the full possible capacity of the Priest Rapids dam. The worth of the Electric Bond & Share [24] Company, wholly owned by the General Electric Company, increased and mounted from the passage of the Water Power Bill, March, 1920, with the forming and buying of utility companies, domestic and foreign, investments by the Hundreds of Millions of Dollars, as a direct result of the improved water power laws. The origin, the starting in 1913, and need for same based almost entirely upon the plans and work of Dam Brothers; the main purpose of the Joint Adventure formed

by them and General Electric-Electric Bond, the successful enactment of the bill which received the valuable and loyal contributions of the Plaintiffs. (R. 35)

### LXXIII

**"That the last five years of this most prosperous period in the history of the United States, for privately owned utilities, termed the 'Electrical Era,' was permitted to pass by the Electric Bond and Share Company by bungling and mismanaged what limited attention they gave the Priest Rapids plans, wasted and dissipated this wonderful opportunity to develop this most favorable water power site, in which the General Electric-Electric Bond had then upwards of \$10,000,000.00 invested."** (R. 36)

### LXXV

**"That because of the depression following the 10 year Electrical Boom and prosperity, the government policy of building large hydroelectric dams, and the World War II years with restriction in the use of Capital, Materials and Labor, development by private utilities was not considered favorable. There was continued hopefulness for the conditions to change and construction of dams by the private power companies throughout the United States."** (R. 36)

### LXXVI

#### **"A Major Priest Rapids Asset Ruined"**

**"That following cessation of hostilities of World War II the Defendants entered into negotiations in fraud of the rights of Dam Brothers therein by selling the total land holdings of the Syndicate-Company on the Priest Rapids Highlands for a nominal sum, and Forever placed said partnership syndicate lands out of the power of the Defendants and Dam Brothers for development and sale. That at all times Dam Brothers served written and verbal notice of their objections to**

any disposition of the said Syndicate lands, either in whole or in part." (R. 37)

## LXXVII

"That in protesting the said proposed sale of the lands, Dam Brothers sent registered mail notices to the defendant companies, General Electric-Electric Bond and Share, and the Columbia Highlands Company, to serve warning of the Defendants' responsibility and their obligations to Dam Brothers for their vast and substantial various investments and interests at Priest Rapids, holding defendants accountable for full losses, damages, and claims, resulting from the sale of said Syndicate lands, or for any other acts committed by them effecting the Priest Rapids assets without full consideration of Dam Brothers interests." (R. 37)

## LXXVIII

### "Tufa Deposit Sold for Paltry Sum"

"That said deposit of Tufa was held by the Priest Rapids power site-industrial land holding company, the Washington Irrigation and Development Company, continually up to about the year 1949, when the Plaintiff learned in the private office of the Western General Counsel for the General Electric-Electric Bond & Share's Pacific Northwest interests, who also was president of the said land holding company, that he had just the week before sold the said Tufa deposit land, for thirty-five hundred dollars. The said sale was made by Defendants without consent or knowledge of Dam Brothers. That plaintiff made vigorous oral objections and complaint to said official, for making the said sale and for not consulting Dam Brothers before even negotiating the sale of the Tufa deposit section of land." (R. 37-38)

## LXXXIII

"That in view of the fact that Defendants recently started to liquidate their utility interests located in the

State of Washington, it became evident to plaintiffs that defendants did not intend to develop the Priest Rapids project and therefore a written demand was made on June 14, 1951, for a full settlement in connection with the Priest Rapids project, in response to which defendants have made no reply." (R. 40)

#### LXXXIV

"That it was just learned by the plaintiffs that the defendants are giving away the entire Priest Rapids power site holdings, the main part of which property holdings have been held in trust by defendants dummy holding company, the Washington Irrigation & Development Company, since its organization in 1910, of which all its common stock has been held by the American Power & Light Company." (R. 40)

#### LXXXV

"That the Defendants have therefore by their own recent actions made the purpose of the joint adventure agreement incapable of performance." (R. 40-41)

#### **2. MOTIONS TO DISMISS ELECTRIC BOND AND SHARE COMPANY AND AMERICAN POWER & LIGHT COMPANY.**

The complaint was met by Electric Bond and Share Company and American Power & Light Company with motions to dismiss on the ground, among others, that those defendants were not doing business in the State of Washington.<sup>4</sup> Prior to the hearing on these motions, plaintiffs filed as of course an unverified amended complaint. (R. 57-73)

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4. Service upon Electric Bond and Share Company had consisted of mailing a copy of the Summons and Complaint to that defendant's office in New York (R. 56), and upon American Power & Light Company by leaving a copy of the Summons and Complaint with the statutory agent of the Washington Irrigation & Development Company (R. 78).

**3. AMENDED COMPLAINT.**

The amended complaint was more carefully tailored to meet the exigencies of pretrial procedure and the eventual-  
ity of a dismissal of the action as to Electric Bond and Share Company and American Power & Light Company. There were the following changes:

The **verified** complaint had recited the 100% ownership of Electric Bond and Share Company by General Electric Company until soon after the year 1925 but had **not** contained allegations of authorized agency. The amended complaint alleged specifically that Electric Bond and Share Company was the agent, servant and representative of General Electric Company and performed the acts alleged as the agent of General Electric Company (R. 57, 58). In addition, the chairman of the Board of General Electric Company, Mr. Charles A. Coffin, was alleged to have represented General Electric in conversations with the plaintiffs and Mr. Sidney Z. Mitchell. Mr. Mitchell, who had been identified in the verified complaint only as the president of Electric Bond and Share Company, was alleged to be the representative and agent of General Electric Company and chairman of the board of American Power & Light Company as well (R. 60).

The **verified** complaint had alleged simply that the "joint venture agreement" was entered into with Electric Bond and Share Company (R. 13, 20). The amended pleading alleged, "\* \* \* the said defendants, General Electric Company, Electric Bond & Share and American Power & Light, and the said Dam Brothers, entered into a joint venture between all of the parties \* \* \*" (R. 63).

The **verified** pleading had stated that the American Power & Light Company owned all the common stock "of its dummy holding company, the Washington Irrigation & Development Company" (R. 4). The amended pleading

alleged that the Washington Irrigation & Development Company was wholly controlled by American Power & Light Company and General Electric Company and was used by them "as a dummy and instrumentality" (R. 58).

Plaintiff had alleged in the **verified** complaint that about 1910 General Electric's "subholding and subsidiaries" made their first investments at Priest Rapids (R. 10). In the amended complaint they alleged that **General Electric Company** had made certain investments at Priest Rapids and that these were held through its "dummy" Washington Irrigation and Development Company (R. 61).

Whereas the **verified** pleading had alleged specifically that **Electric Bond and Share Company** had permitted five years of prosperity to pass without developing Priest Rapids (R. 36) although the "defendants could have easily financed and constructed said dam, \* \* \*" (R. 35) the amended complaint simply recited that the defendants "did not then proceed with the construction of the dam at Priest Rapids, and prior to the time that construction could begin there had occurred a general depression in the United States \* \* \*" (R. 69).

To cover some of the twenty-seven year period between the granting of the license to build the dam and the commencement of the action, the amended complaint added the general allegations that "\* \* \* the defendants represented to said plaintiffs that they were continuing with said co-adventure \* \* \*" and "\* \* \* that none of defendants did state, nor did they represent at any time to said plaintiffs, that they were in anywise abandoning the prosecution of the co-adventure; that the plaintiffs herein did not and could not know that there was any complete or final repudiation or abandonment of the agreement of co-adventure until some time in the early part of the year 1951 when plaintiffs learned that defendants, and all of them, did not intend to

proceed with the development of the Priest Rapids project or with the prosecution of any of the obligations assumed by them; \* \* \*" (R. 69, 70).

The omissions were equally significant:

Although the amended pleading continued to characterize the relationship of the parties by the conclusory allegations "joint venture" and "partnership," it failed to mention the conspiracies and breaches of contract described in the **verified** complaint as occurring before and shortly after passage of the water power legislation (R. 24, 26-27).

Also omitted were the allegations that General Electric Company had distributed to its stockholders all the common stock of Electric Bond and Share Company "soon after 1925" (R. 8), and that American Power & Light Company was wholly under Electric Bond and Share's domination "until November 1935" (R. 9).

Finally, although it was apparent from the prayer of the amended complaint that the defendants had never proceeded with the development of Priest Rapids, had never issued to plaintiffs any shares in a Priest Rapids power company "upon the passage" of the water power legislation (R. 65), and had never conveyed any interest in any companies or syndicates to plaintiffs at any time, the amended pleading studiously avoided the express allegations of the verified complaint that "with the passage by the United States Congress of the Water Power Bill, the **Electric Bond & Share Company** would at once start all the activities at Priest Rapids and the commitments would all then be taken care of together \* \* \*" (R. 17, 18), that in 1922 Mr. Mitchell recommitted the "General Electric-Electric Bond and Share," giving his "positive assurance \* \* \* that **General Electric-Electric Bond** were ready to get started right away for letting the construction contract dam at

"Priest Rapids" (R. 30, 31), and that "the General Electric-Electric Bond and Share failed to fulfill any of their commitments to Dam Brothers during the periods mentioned in the complaint" (R. 39).

The amended complaint also contained a second cause of action incorporating the allegations of the first alleged cause of action and asking for recovery on the theory of benefits conferred.

#### **4. ORDERS DISMISSING ELECTRIC BOND AND SHARE COMPANY AND AMERICAN POWER & LIGHT COMPANY.**

After the filing of the amended complaint, the court entered its order (R. 92) quashing service and dismissing as to American Power & Light Company on the ground that defendant did not do business in the State of Washington. A similar order was later entered as to Electric Bond and Share Company (R. 125).<sup>5</sup> The granting of these motions left General Electric Company the sole defendant before the court.

#### **5. SECOND AMENDED COMPLAINT.**

After the dismissal of American Power & Light Company and pending consideration of the motion to dismiss Electric Bond and Share Company, the plaintiffs moved the court for, and were granted, permission to serve and file a second amended complaint (R. 93, 94-95).

The second amended complaint (R. 96) even more than the amended complaint was an embodiment of the "pleader's hope"<sup>6</sup> rather than a statement of the case as it was actually

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5. No appeal was taken by plaintiffs from these orders.

6. Clark, *The Summary Judgment*, 36 Minn. Law Review 567. At page 571 Judge Clark wrote: "The touchstone, thus, is the absence of a genuine issue as to a material fact. These are very carefully chosen words intended to express a definite thought. Various courts have attempted to better this formula by others which tend

"shown to be" by the verified complaint, the affidavits later filed, and the statements of plaintiffs' counsel to the court.

With General Electric Company the only defendant remaining before the court, the allegations were sharply pointed toward it. Allegations in the **verified** complaint that had referred only to Electric Bond and Share Company and allegations in the amended complaint that had referred to General Electric Company and Electric Bond and Share Company were changed to refer to General Electric Company alone, or General Electric Company acting through its subsidiaries.<sup>7</sup>

to bend the principle to their ideas of policy—with deleterious results, as I shall point out later. But note, too, that the judge is to apply this principle after examining everything before him in the file: pleadings, affidavits, depositions or admissions. This is important. **He takes the case as it is shown to be, not as the formal allegations of a pleading may have embodied a pleader's hope."**

7. The dismissals not only left General Electric Company the sole defendant before the court, but left a serious question as to whether on the basis of the allegations of the **verified** complaint, plaintiffs could proceed against General Electric alone, as the other defendants might well have been indispensable parties. Some of the changes made were the following:

(a) The **verified** complaint had alleged the concern of Mr. Mitchell, president of **Electric Bond and Share Company**, about the Dam Brothers' plans at Priest Rapids. (R. 12) The amended complaint referred to the "defendant corporations" (R. 62) and the second amended complaint referred to General Electric Company alone (R. 105-107).

(b) With reference to the formation of the joint venture, the **verified** complaint had alleged simply that it was formed with **Electric Bond and Share Company** (R. 13). The amended complaint alleged that it was formed with defendants, General Electric Company, Electric Bond and Share Company, and American Power & Light Company (R. 63), and the second amended complaint alleged that the joint venture was agreed upon with General Electric Company and its subsidiary and agent, Electric Bond and Share Company (R. 108).

(c) With regard to the lands to be acquired pursuant to the joint venture, the **verified** complaint had alleged that some of them were to be turned over to **Electric Bond and Share Company**, and others were to be acquired jointly with

In harmony with these changes, the second amended complaint contained lengthy allegations of the domination of Electric Bond and Share Company by General Electric Company and the use by General Electric of that corporation for its own purposes (R. 98-101). The amended complaint had alleged that Electric Bond and Share Company was the agent of General Electric Company (R. 57, 58) but had not alleged any facts on the basis of which the separate corporate entity of Electric Bond and Share Company could be disregarded. The **verified** complaint had alleged simply that Electric Bond and Share Company was "100% wholly

**Electric Bond and Share Company**; that the syndicate was to be limited to Dam Brothers, **Electric Bond and Share Company**, and a few of its officials, and that the syndicate was actually formed with the Dam Brothers and **Electric Bond and Share Company** (R. 14, 15, 17, 19). The amended complaint referred to "defendant corporations and their various officials" (R. 65) and the second amended complaint alleged that the lands were to be turned over to or jointly acquired with General Electric Company or its subsidiaries or agents as directed by General Electric Company (R. 110).

(d) Regarding the start of the dam, the **verified** complaint had alleged **Electric Bond and Share Company** would start the activities at Priest Rapids (R. 17). The amended complaint referred simply to "defendants." (R. 66) and the second amended complaint referred to General Electric Company or its subsidiaries acting for it under its direction and control (R. 113, 116, 117-118).

(e) The **verified** complaint had alleged that the Dam Brothers referred the attention of Electric Bond and Share to the tufa deposit, and that officials of American Power & Light and General Electric Company "expressed interest" in it (R. 22, 23). The second amended complaint referred to General Electric Company and to its representatives and agents and to the representatives and agents of subsidiaries under the control of General Electric Company (R. 114).

(f) The allegations of the **verified** complaint relating to the post license period had referred to the "defendants" and to Electric Bond and Share Company's having permitted the period to pass without developing the Priest Rapids power site (R. 34 et seq.). The amended complaint referred simply to "defendants" (R. 68) and the second amended complaint referred to General Electric alone or General Electric and its subsidiaries (R. 117-118).

owned" by General Electric Company until "soon after 1925" (R. 8) and General Electric Company was "behind its development plans" (R. 16).

The only specific allegation in the second amended complaint, on the subject of assurances of performance by "defendants" and lack of knowledge by plaintiffs of abandonment of the joint venture, related to matters occurring about or before 1925:

## XXI.

"In further performance of said joint venture agreement on their part to be performed, the plaintiffs acquired for the land syndicate formed for such purpose under the joint venture agreement, the fifty-five thousand (55,000) acres of land for irrigation, and other lands, some of which had previously been acquired by the defendant, General Electric Company, acting through a subsidiary controlled by it, and including lands to be included in the corporation Townsite Terminal Company above referred to. The plaintiffs further in the performance of said joint venture agreement on their part to be performed, at the request of and under the direction of the defendant, General Electric Company, and its agents, representatives and subsidiary corporations under its domination, direction and control, secured the above-mentioned Tufa deposits immediately adjacent to the proposed dam and townsite, in the contemplation of the parties, and which deposits it was agreed between the parties were to be turned over to a corporation to be organized as the Tufa Natural Cement Company, which was within the contemplation of such joint venture agreement." (R. 116-117)

## XXII.

"After the passage of legislation favorable to the development of the Priest Rapids project by the Con-

gress of the United States in 1920, the General Electric Company through its agents and representatives, and through its subsidiary, Electric Bond & Share Company, dominated, directed and controlled by the defendant, General Electric Company, and through its complicated [16] and confusing and in some instances wholly fictitious, corporate setups, caused diamond drilling and other engineering services to be done and performed at the said Priest Rapids site, and in the vicinity thereof, for the purpose of making estimates and determinations as to the probable costs and specification necessary for the construction of such proposed dam and other improvements. Prior to such times the defendant, by and through one of its subsidiaries acting under its domination, direction and control had secured a permit and later a license to construct the proposed dam for the purpose of producing and manufacturing hydroelectric power at said Priest Rapids site." (R. 117)

### XXIII.

"The said permit for the construction of said dam was granted about the year 1925, and at said time, by public declaration through the press and by private communication to the plaintiffs by and through the defendant, General Electric Company and its subsidiaries acting under its domination, direction and control, affirmed and reaffirmed its intention to **immediately** proceed with the proposed project, and these plaintiffs believed and relied upon the statements and assurances so made by and under the direction of the defendant, General Electric, that such project would be pushed to full realization and fruition." (R. 117-118)

The general allegations on this subject, which had first appeared in the amended complaint, were amplified as follows:

## XXIV.

"The said defendant, General Electric Company, to the knowledge of these plaintiffs, at no time abandoned the performance of such joint venture agreement on its part, nor did it notify the plaintiffs to that effect, but at all times advised and assured these plaintiffs that it still proposed and intended to proceed with the said proposed plans, but following the securing of such license, about the year 1929, the entire United States was in a depression following World War No. I, and following this the United States entered World War No. II, all of which [17] resulted in Government controls of metals and materials which would be needed and required in the prosecution of such development and project, and as a result thereof the said defendant, General Electric Company, was hampered and delayed in prosecuting and proceeding with the development of said Priest Rapids, but at all times the said General Electric Company advised and assured the plaintiffs that it fully intended to perform its part of said joint venture agreement, which advice and assurances the plaintiffs believed and relied upon." (R. 118)

Allegations of the **verified** complaint that had been omitted significantly from the amended complaint were also omitted from the second amended complaint but in addition the second amended complaint omitted any reference to the date of the making of the alleged "joint venture" agreement and to the fact that it was oral.<sup>8</sup>

The second amended complaint, like the earlier pleadings, showed from its prayer that the defendants had never carried out any of their alleged commitments.

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8. The verified complaint alleged clearly that the agreement was made in 1913 (R. 13, 14), but did not expressly allege the agreement was oral. The amended complaint specified April, 1913 as the date of the agreement and alleged that it had never been reduced to writing (R. 63).

**6. MOTIONS TO STRIKE AND TO MAKE MORE DEFINITE AND CERTAIN—GRANTED IN PART; MOTION TO DISMISS—DECISION WITHHELD; ARGUMENT OF COUNSEL ON LACHES.**

General Electric filed, concurrently, motions to strike, to make more definite and certain, and to dismiss (R. 127-134). The motions were heard by the court. Although the arguments dealt with General Electric Company's contention that the second amended complaint should be dismissed because of laches, plaintiffs' counsel made **no** reference to **any evidence of facts** which would make inapplicable, for the twenty-seven year period between the granting of the license to build the dam and the commencement of the action, accepted rules of law on accrual of causes of action, limitations and laches. There was every indication from the lengthy statement of plaintiffs' counsel (R. 144-158) that there was no such evidence. Thus, plaintiffs' counsel stated:

"Now, immediately on the passage of that legislation, the General Electric began to do some diamond drilling down on this project, but they scattered their energies over the United States in about 265 different places, and because of the fact that they could get easier picking in all of the smaller places where they would have absolute control themselves, **they neglected this place**, and your Honor has read many, many, many times in the general public news where the General Electric is going to do this at Priest Rapids and General Electric and General Electric, and so on." (R. 147)

"\* \* \* They wanted some means of contacting the public and the General organized the Electric Bond and Share and did all there was to it and trained their men in the General Electric and set them over the Electric Bond and Share and owned every single share of stock in that company until the S.E.C. told them to distribute that stuff to the stockholders of the General Electric."<sup>9</sup> (R. 147-148)

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9. The SEC action referred to by counsel for plaintiffs and stated by him to be reported in SEC Vol. XI, was against Electric

"The very same grasshoppers, if your Honor please, are sitting on the same bushes up on that hill now. You can't tell any difference in the territory there at all. They did do a lot of diamond drilling, but they got all their money back, no doubt, from deductions in their income taxes and things of that kind \* \* \*." (R. 150-151)

"Now, then, all we want these people to do is to come in and answer and show us, show the Court, that they have done anything except very superficial work there in doing some diamond drilling and the camouflaging the ownership there, and whenever the General Electric would come out and talk about it, the papers would say General Electric is going to do this and General Electric is going to do that." (R. 152)

The court granted in part the motions to strike and make more definite and certain, and notified counsel that it would withhold decision on the motion to dismiss until plaintiffs had complied with the order on the two other motions. Plaintiffs, in compliance with the order, consented to the clerk's deleting the portions ordered stricken and inserting allegations that the agreement was oral, was made in 1913, and was made for the defendants by Charles A. Coffin, Sidney Z. Mitchell and Henry Pierce.

**7. RENEWED MOTION TO DISMISS GENERAL ELECTRIC COMPANY; DENIED ON GROUND NOT TO BE TREATED AS MOTION FOR SUMMARY JUDGMENT UNTIL AFTER ANSWER.**

General Electric Company then renewed its motion to dismiss, supporting its renewed motion with affidavits estab-

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Bond and Share, and the decision stated that General Electric had disposed of all its investment in Electric Bond and Share in 1925.

Statements of counsel have been considered in the determination of whether or not there is a genuine issue as to material facts. See *Creel v. Lone Star Defense Corporation*, 171 F.2d 964 (Cir. 5, 1949) at 967.

lishing these facts: Charles A. Coffin died in 1926; Sidney Z. Mitchell in 1944; and Henry J. Pierce more than 30 years before; Edwin Wilbur Rice was president of General Electric Company from 1913 to 1922 and died in 1935; Priest Rapids Power Company, Terminal Townsite Company and Tufa Natural Cement Company had never qualified to do business in the State of Washington as either foreign or domestic corporations at any time since 1912.<sup>10</sup>

Plaintiffs filed in opposition to the motion an affidavit of Milton E. Dam (R. 173-185). Apart from quotations about Charles A. Coffin published in various magazines during the 1920's, the affidavit did **not** refer to any event occurring within **thirty** years of the commencement of the action.<sup>11</sup>

The court then advised the parties that since affidavits had been submitted in support of the motion, it proposed to

10. The verified, the amended and the second amended complaints had all alleged that the Priest Rapids Power Company was to be formed "upon passage of federal power legislation." The verified and amended complaints had alleged the Terminal Townsite Company was to be incorporated when the power company was formed, and the second amended complaint alleged it was to be formed "immediately" following passage of favorable legislation. There was **no** allegation in any of the complaints that these companies had ever been incorporated.

11. The tenor of the entire affidavit is the same as that of the verified complaint. The following statement is an example:

"That during the Joint Adventure conferences, Dam Brothers were assured that the plans desired by and backed by the General Electric, would be carried; that with the start of the activities following the conferences, the Dam Brothers were to work with and operate under Mr. Mitchell, president of Electric Bond, which organization had the legal structure and engineering equipment; that the permanent organizations for the Power Company, the Terminal Townsite Company, for vital mining and minerals, would all be formed after the federal water power legislation had been obtained.

"That as late as 8 years after the Joint Adventure conferences, following the enactment of the federal legislation, one of the main achievements accomplished, and Mr. Coffin was ready to retire at the age of 79, he still had to be consulted by Mr. Mitchell, and obtain Mr. Coffin's approval." (R. 184)

treat it as one for summary judgment under Rule 12(b).<sup>12</sup> Plaintiffs were granted a period of two weeks within which to file additional affidavits or other matters they wished to submit for the court's consideration (R. 188).

Two months later plaintiffs filed an additional affidavit (R. 190-196). This affidavit, too, failed to refer to any facts relating to the defense of limitations and laches. The only specific allegations regarding the relationship of the plaintiffs to General Electric Company referred to a period **twenty-seven or more years** before the commencement of the action.<sup>13</sup>

The court next wrote counsel advising them that in its opinion it was "doubtful at least that such defenses (laches, statute of frauds, and limitations) could properly be passed upon by order on motion to dismiss treated as a motion for

12. Rule 12(b) provides in part:

"If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56."

13. The tenor of this affidavit, like that of the affidavit previously filed and like the argument of plaintiffs' counsel at the hearing on the motion to dismiss, was the same as that of the verified complaint.

The court refused at first to consider it at all because it was filed late, because it was in effect an answering argument to a memorandum of General Electric interposed directly by a litigant represented by counsel, and finally because "the affidavit contained little, if any, direct factual statement to which the affiant could testify if he were a witness in the case" (R. 197). The court later advised counsel that on the motion for summary judgment it was considering **all** the material in the file of the case (R. 201, 237).

The affidavit referred to "the complete mass of connecting evidence" (R. 194) and stated that "\*\*\*\* the Complaint and Documents already filed contain honest to God facts and truth about this affair \*\*\*" (R. 195). Such allegations do not create genuine issues. See the discussion at pp. 33 to 35 *infra*.

summary judgment" (R. 201)<sup>14</sup> and upon this ground denied the motion.<sup>15</sup>

#### **8. ANSWER BY GENERAL ELECTRIC COMPANY.**

After denial of the motion, General Electric Company filed its answer. It admitted that General Electric Company had caused Electric Bond and Share Company to be incorporated in 1905; that Charles A. Coffin was the founder of General Electric Company and chairman of the board of that company in 1913; that in the same year Electric Bond and Share Company was wholly owned by General Electric Company and Sidney Z. Mitchell was president of Electric Bond and Share; that Congress enacted the Federal Water Power Act in 1920; that the public files of the Federal Power Commission showed that a preliminary permit to build a dam at Priest Rapids was issued to Washington Irrigation and Development Company in 1921 and a license in 1925; and certain geographical facts about the Columbia River. The remaining allegations were denied and affirmative defenses pleaded, including the statute of frauds, limitations and laches (R. 204-214).

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14. The court was probably incorrect in concluding that it was doubtful that it could pass on the motion for summary judgment prior to the filing of an answer. See *Suckow Borax Mines Consol. v. Borax Consolidated*, 185 F.2d 196 (Cir. 9, 1950).

The letter indicates the care with which the court considered the whole matter and its commendably cautious attitude toward clearly highlighting the issues raised by General Electric Company's motion.

15. With reference to its denial of the motion, the court stated: "I assume General Electric Company in its answer will affirmatively plead the three defenses to which I have above referred, and will renew its motion as a motion for summary judgment. I see no reason why the motion then could not be considered and passed upon by the court on the basis of the complaint and answer, and affidavits and other factual material already submitted in connection with the motion to dismiss, and on counsels' various memoranda and lists of authorities heretofore submitted on the motion" (R. 201-202).

**9. MOTION FOR SUMMARY JUDGMENT.**

Concurrently with the answer, General Electric Company filed a motion for summary judgment and an additional affidavit establishing these facts: That the files of the Federal Power Commission in Washington, D. C., showed that in 1920 Washington Irrigation and Development Co. had applied for a preliminary permit for a power project at Priest Rapids; the permit was granted on March 3, 1921, and pursuant to the permit, a license was issued in March 1925, which, as amended in March 1927, required that construction be commenced on or before March 1, 1929; the license was terminated by the Commission on June 14, 1929 because of the licensee's failure to commence construction; an application for a new license on the same project was filed by the Washington Irrigation and Development Co. in 1929 and was denied; and on March 2, 1930, the executive secretary of the Commission wrote to the applicant that the required showing not having been made, the second license application had been denied and the file closed; that there was no activity regarding Priest Rapids so far as shown by the public files of the Federal Power Commission from the closing of the Washington Irrigation and Development Co. files on March 2, 1930 until July 16, 1952, when plaintiffs instituted this action (R. 214-220).<sup>16</sup>

**10. MOTION TO ADJOURN HEARING.**

After service of the motion for summary judgment, plaintiffs filed a motion for an order continuing and adjourning the hearing on the motion upon the ground that there were genuine issues of material fact in the action. Plaintiffs' attorney filed a lengthy affidavit (R. 222 to 235) which specified in detail matters on which there was a factual dispute.

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16. The affidavit was supported by certified copies of the docket sheet and other documents on file in the office of the Federal Power Commission.

None of these matters was material to the defenses of limitations or laches, and the affidavit contained no allegations controverting the showing made by General Electric Company, or stating evidence of facts which would make inapplicable accepted rules on accrual of causes of actions, limitations and laches.<sup>17</sup>

The court ordered plaintiffs' motion stricken on the basis that there was no authority for such a motion and on the further ground that the motion merely raised the very issue before the court—whether or not there was a genuine issue as to a material fact.<sup>18</sup>

#### **11. OPINION; ORDER GRANTING MOTION FOR SUMMARY JUDGMENT; JUDGMENT.**

On August 27, 1956, the court filed its opinion (R. 235) and granted defendant's motion on the ground of limitations and laches. Thereafter, on August 3, 1956, summary judgment was duly entered (R. 255).

### III.

#### **ARGUMENT**

##### **A. On Motion for Summary Judgment the Duty of the District Court Was to Pierce the Formal Allegations of the Pleadings, Reach the Merits of the Controversy, and Determine Whether There Was any Genuine Issue as to any Fact Material to the Defenses Raised by Defendant, Namely, the Statute of Limitations and Laches.**

Rule 56 by its plain terms and by construction with other rules<sup>19</sup> requires the court upon appropriate motion, to pierce

17. See the discussion *infra*, pp. 33-34, for the effect of mere assertions that there are disputed issues of fact without specifying what the evidence would be.

18. At this time the court also wrote counsel advising them that in passing upon the motion it would consider "all the relevant material—factual and legal—in the file of the ease" (R. 237).

19. Tests of the sufficiency of the pleadings and the raising of matters which are the subject of the common law demurrer are amply provided for by Rule 12. See also Rules 8, 9 and 10.

the formal allegations of the pleadings, reach the merits of the controversy, and determine in advance of trial if there is any "genuine issue as to any material fact."<sup>20</sup> In making this determination, the court must act with caution, as the constitutional right to trial by jury is involved,<sup>21</sup> and if a genuine issue of fact material to the claim or defense asserted by the motion is found, the motion must be denied. But the rule grants to litigants the right to such determination because "A court has refused in granting justice when it forces a party to an expensive trial of several weeks duration to meet purely formal allegations without substance fully as much as when it improperly refuses to hear a case at all,"<sup>22</sup> and because of "the danger that the threat of such a trial will be used as a type of harrassment to coerce a settlement."<sup>23</sup>

20. For an excellent description of the function of the District Court on motion for summary judgment, see the recent Ninth Circuit case, *Byrnes v. Mutual Life Insurance Company of New York*, 217 F.2d 497 (Cir. 9, 1954).

See also *Suckow Borax Mines Consol. v. Borax Consolidated*, *supra* fn. 14, where the Court stated at 205: "The whole purpose of the summary judgment rule is to separate real and genuine issues from mere formal or pretended issues." and Clark, *op. cit.*, *supra*, note 6 at 573 where Judge Clark stated: "\*\*\*\* the summary judgment searches for the merits \*\*\*\*."

21. *Griffeth v. Utah Power & Light Company*, 226 F.2d 661 (Cir. 9, 1955).

22. Clark, *op. cit.* *supra*, fn. 6, at 578.

23. MacAsville and Snell, Summary Judgment under the Federal Rules—When an Issue of Fact is Presented, 51 Mich. L. Rev., 1143, at 1143 and 1144. The court below may have had this reason for the summary judgment procedure in mind when in oral argument counsel for the plaintiffs stated:

"But, if your Honor please, this is what ought to be done. There is a chance that it might be done, and I am certainly not suggesting that anybody else has waved any encouraging flags in my face. I don't want it to appear that way, but I think this: \*\*\*\*"

"\*\*\*\* they have done nothing for the Dam Brothers, and I was just going to conclude by saying, if your Honor please,

The rule makes the procedure available to both plaintiffs and defendants, recognizing the principle that "while the patently unmeritorious claim has not so often recurred as the sham defense, yet when the former does arise, it affords as much hardship to the other party and as much burden upon judicial machinery as the latter."<sup>24</sup>

Since the wholesome purpose of Rule 56 can be achieved only if the court reaches the merits, it is the duty of both parties to disclose fully what the evidence will be on the issues raised by the motion.<sup>25</sup> Formal allegations in plead-

that if your Honor would peruse these, I can't expect the Court to be Solomon and know everything, I am just assuming that it is necessary to read briefs and things of that kind in order to reach correct conclusions, and if that could be done and the case remain status quo until probably in the next term, that we might avoid the necessity of a long trial in this court if the Court was to sustain our complaint." (R. 154-157)

See *Altman v. Curtiss-Wright Corporation*, 124 F.2d 177 (Cir. 2, 1941) where, in affirming a summary judgment, the court stated at 180: "There was no issue to try, and the remedy of summary judgment is designed to bar exactly such opportunities for unjust exactions to escape the delay and expense of a trial."

24. Pike and Willis, The New Federal Deposition-Discovery Procedure : II, 38 Colum. L. Rev. 1436 at 1456.

25. See *Engl v. Aetna Life Ins. Co.*, 139 F.2d 469 (Cir. 2, 1943) where the court stated at 473, "If one may thus reserve one's evidence when faced with a motion for summary judgment there would be little opportunity 'to pierce the allegations of fact in the pleadings' or to determine that the issues formally raised were in fact sham or otherwise unsubstantial. It is hard to see why a litigant could not then generally avail himself of this means of delaying presentation of his case until the trial. So easy a method of rendering useless the very valuable remedy of summary judgment is not suggested in any part of its history or in any one of the applicable decisions."

See also *Chambers & Company v. Equitable Life Assurance Soc.*, 224 F.2d 338 (Cir. 5, 1955) at 345 where the court stated: "It was not permissible that Appellant hold back any evidence or fail to make a full disclosure of the facts upon which it relied for recovery. Disclosure under summary judgment must be full and complete." And *Carr v. Goodyear Tire & Rubber Co.*, 64 F. Supp. 40 (D.C.

ings, that may be sufficient for other purposes, do not sufficiently disclose the evidence for the purpose of Rule 56, for if a genuine "issue could be raised by the pleadings alone, Rule 56 would be a nullity \* \* \* it would merely duplicate the motion to dismiss."<sup>26</sup> Nor does a party fulfill the duty

Calif., 1945) where the court, adopting the language of another case, stated at page 51: " \* \* \* on such a motion it is the duty of counsel for plaintiff and defendant to fully disclose what the evidence will be on the issues raised by the motion \* \* \*."

26. *Lindsey v. Leavy*, 149 F.2d 899 (Cir. 9, 1945). The complete statement appears at page 902: "The sufficiency of the allegations of a complaint do not determine the motion for summary judgment. Cases dealing with and construing Rule 56, Federal Rules of Civil Procedure, 28 U.S.C.A. following section 723e, clearly indicate to the contrary and if this were not the case, Rule 56 would be a nullity for it would merely duplicate the motion to dismiss." For other Ninth Circuit cases, see: *Byrnes v. Mutual Life Insurance Company of New York*, supra fn. 20 at 500; *Koepke v. Fontecchio*, 177 F.2d 125 (Cir. 9, 1949). At 127 the court stated: "The purpose of the procedural rule 56, Federal Rules of Civil Procedure, 28 U.S.C.A., providing for the rendering of summary judgment is to dispose of cases where there is no genuine issue of fact even though an issue may be raised formally by the pleadings."

For cases from other jurisdictions see: *Appolonio v. Baxter*, 217 F.2d 267 (Cir. 6, 1954) at 270; *Reynolds v. Maples*, 214 F.2d 395 (Cir. 5, 1954) at 399; *Zampos v. United States Smelting Refining and Min. Co.*, 206 F.2d 171 (Cir. 10, 1953) at 173, 174; *Surkin v. Charteris*, 197 F.2d 77 (Cir. 5, 1952) at 79; *Christianson v. Gaines*, 174 F.2d 534 (Cir. D.C., 1949) at 537; *Engl. v. Aetna Life Ins. Co.*, supra fn. 25, at 472-473; *Meyers v. District of Columbia*, 17 F.R.D. 216 (D.C. District of Columbia, 1955) at 220; *Kowalewski v. City of Hastings*, 112 F. Supp. 825 (D.C. Minn. 1953) at 827-828; *McClellan v. Montana-Dakota Utilities Co.*, 104 F. Supp. 46 (D.C. Minn. 1952) at 56; *Crosby v. Oliver Corporation*, 9 F.R.D. 110 (D.C. Ohio, 1949) at 112; *Geller v. Transamerica Corporation*, 53 F. Supp. 625 (D.C. Del. 1943) at 629.

The only circuit in which the question has arisen and in which this rule has not been followed is the Third. For an excellent discussion of the rule and criticism of the Third Circuit holdings, see Wright, Rule 56(e): A Case Study on the Need for Amending the Federal Rules, 69 Harv. L. Rev., 839.

In its report of October 1955 on Proposed Amendments to the Rules of Civil Procedure for the United States District Courts, the Advisory Committee on Rules for Civil Procedure stated the following: "The purpose of Rule 56 is to pierce the formal allegations of the pleadings and reach immediately the merits of the controversy. If pleading allegations are sufficient to raise a genuine issue as

of full disclosure by mere denials of matters in support of the motion,<sup>27</sup> expressions of hope that evidence will be available at the time of trial,<sup>28</sup> simple assertions that a question of facts exists,<sup>29</sup> or statements that further evidence will be produced at trial.<sup>30</sup>

When a party moves for summary judgment and supports its motion with "evidence on which, taken by itself, it would be entitled to a directed verdict \* \* \*" it rests upon the other party "at least to specify some opposing evidence which it can adduce and which will change the result."<sup>31</sup> If

against uncontradicted evidentiary matter, this remedy then becomes substantially without utility \* \* \*. The view of most cases and commentators is that, where the motion for summary judgment is supported by depositions or affidavits, the opposing party must make a similar presentation to show the existence of a genuine issue of fact, or suffer judgment to be entered." \* \* \*

See also discussion in Clark, op. cit., supra, fn. 6, at 571, and MacAsville and Snell, op. cit., supra, fn. 23.

27. *Piantadosi v. Loew's Inc.*, 137 F.2d 534 (Cir. 9, 1943). At 536 the court stated: "Under this rule (Rule 56(e)) mere denials, unaccompanied by any facts which would be admissible in evidence at a hearing, are not sufficient to raise genuine issue of fact."

28. *Poole v. Gillison*, 15 F.R.D. 194 (D.C. Ark., 1953), at 198.

29. *Felt v. Ronson Art Metal Works*, 107 F. Supp. 84 (D.C. Minn., 1952) at 85; *Wier v. Texas Co.*, 79 F. Supp. 299 (D.C. La. 1948) at 311.

30. *Appolonio v. Baxter*, supra fn. 26 at 270 et seq.; *Engl v. Aetna Life Ins. Co.*, supra fn. 25, at 473.

31. *Byrnes v. Mutual Life Insurance Company of New York*, supra fn. 20 at 501.

See also: *Suckow Borax Mines Consol. v. Borax Consolidated*, supra fn. 14 at 205; *Gifford v. Travelers Protective Ass'n.*, 153 F.2d 209 (Cir. 9, 1946) at 211; *Piantadosi v. Loew's Inc.*, supra fn. 27, at 536; *Chambers & Company v. Equitable Life Assurance Soc.*, supra fn. 25 at 345 et seq.; *Appolonio v. Baxter*, supra fn. 26, at 270; *Repsold v. New York Life Insurance Company*, 216 F.2d 479 (Cir. 7, 1954) at 483; *Marion County Cooperative Ass'n. v. Carnation Co.*, 214 F.2d 557 (Cir. 8, 1954) 561-562; *Reynolds v. Maples*, supra fn. 26, at 399; *Zampos v. United States Smelting Refining and Min. Co.*, supra fn. 26; *Surkin v. Charteris*, supra fn. 26, at 79; *Nahtel Corporation v. West Virginia Pulp & Paper Co. et al.*, 141 F.2d 1 (Cir.

the opposing party does not specify such evidence, it is the duty of the court to proceed on the record before it<sup>32</sup>.

**B. Defendant Presented Evidence Which, of Itself, Established That (1) Defendant, to the Knowledge of Plaintiffs, Never Performed the Alleged 1913 Oral Contract and, Many Years Before the Commencement of the Action, Made Clear by Its Acts and Conduct That Its Part of Such Alleged Oral Contract Would Not Be Performed, and (2) All Individuals Who Allegedly Acted for Defendant in Making the Alleged Oral Contract Had Died Eight Years or More Before the Commencement of the Action.**

The defendant made its motion for summary judgment upon filing its answer to the second amended complaint. Upon consideration of the matter the District Court had before it the following evidence (in addition to admissions in plaintiffs' affidavits and earlier pleadings):

An admission in the second amended complaint that the defendant had never formed a "Priest Rapids Power Company" or a "Terminal Townsite Company" nor issued shares

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2, 1944) at 3; *Engl v. Aetna Life Ins. Co.*, *supra* fn. 25, at 471-473; *Meyers v. District of Columbia*, *supra* fn. 26, at 220-221; *McClellan v. Montana-Dakota Utilities Co.*, *supra* fn. 26, at 56; *Felt v. Ronson Art Metal Works*, *supra* fn. 29, at 85; *Hisel v. Chrysler Corp.*, 94 F. Supp. 996 (D.C. Mo., 1951) at 1003; *Wier v. Texas Co.*, *supra* fn. 29, at 311; *Peckham v. Ronrico Corporation*, 7 F.R.D. 324 (D.C. Puerto Rico, 1947) at 326; *Carr v. Goodyear Tire & Rubber Co.*, *supra*, fn. 25, at 51; *Garcia v. United States*, 108 F. Supp. 608 (U.S.C.C. 1952) at 613.

This rule, like any other, is of course applied with discretion and flexibility. Thus, there are instances where the moving party's own affidavits may show that there are factual conflicts which should properly be decided after full hearing. This type of case occurs where the moving party's affidavits admit circumstances from which a trier of fact could draw opposing inferences and the moving party states as a fact that one inference should be drawn rather than another. For a Ninth Circuit case of this type, see *Hoffman v. Babbitt Bros. Trading Co.*, 203 F.2d 636 (Cir. 9, 1953).

32. *Engl v. Aetna Life Ins. Co.*, *supra*, fn. 25. *Carr v. Goodyear Tire & Rubber Co.*, *supra*, fn. 25, at 51.

in any of those companies to the plaintiffs, although the defendant had allegedly agreed to form those companies upon passage of the Federal power legislation and issue shares in them to the plaintiffs;

An affidavit that these corporations had never been formed or qualified to do business in the State of Washington since 1912;

An admission in the second amended complaint that the defendant had never built the dam at Priest Rapids, although the defendant had allegedly agreed in 1913 to "diligently prosecute" all activities for the development of the Priest Rapids project, and in 1925 had allegedly reaffirmed its intention to "immediately proceed" (R. 118) with the project;

An affidavit that an application had been filed in 1920 with the Federal Power Commission by a Washington Irrigation and Development Co. for a preliminary permit for a power project at Priest Rapids; that the permit had been granted in 1921, followed by issuance of the license in 1925; that the license was terminated in 1929 and an application for a new license filed by that company in the same year; that the application was denied and in 1930 the file of the Federal Power Commission closed; and that after 1930 there was no activity by anyone regarding Priest Rapids on the Columbia River, so far as was shown by the public files of the Federal Power Commission, up to the time plaintiffs commenced this action on July 16, 1952;

Affidavits that all the persons described in the second amended complaint, as the individuals who had acted for defendant in making the oral agreement, had died eight or more years before the commencement of the action.

This evidence, taken by itself, fully established that the action was founded upon an alleged oral contract made in

1913; that the defendant, to the knowledge of plaintiffs, had never performed such alleged oral contract and, many years before the commencement of the action, made it clear by its acts and conduct that its part of such alleged oral contract would not be performed; and that all individuals who had allegedly acted for defendants in making such alleged oral contract had died eight years or more before the commencement of the action. The material facts are set forth in the opinion of the District Court in these words:

"By the oral joint venture contract, defendant agreed immediately after the passage of Federal water power legislation to organize a corporation to be known as the Priest Rapids Power Company with a capital stock of \$40,000,000, and to turn over \$500,000 worth of the stock to the plaintiffs; to organize a corporation to be known as the Terminal Townsite Company, and transfer 10% of the stock to plaintiffs; and diligently to build a dam across the Columbia River at the Priest Rapids site, and allied works for the generation of electrical energy, and the irrigation of arid lands. The passage of the Federal water power legislation occurred in March, 1920. There is no allegation that defendant caused any corporations to be incorporated or transferred any stock in any corporation to the plaintiffs. It may properly be inferred from the defendant's uncontroverted showing on that point that no corporation was ever organized. Defendant's failure to do so breached the contract. Defendant did not build the dam and plaintiffs did not commence their action until 32 years after the passage of the Federal water power act. Defendant<sup>33</sup> did procure a license from the

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33. The District Court assumed "for the purpose of deciding the motion for summary judgment" that Washington Irrigation & Development Co. was a "dominated subsidiary and agent of defendant" (R. 245). This assumption is overly-generous to plaintiffs for any period and especially for the period after 1925. The verified complaint alleges that:

(a) Since the organization of Washington Irrigation & Development Co. in 1910 all of its common stock has been owned by Amer-

Federal Power Commission to build the dam, it is true, but the license was finally canceled and the file closed on July 2, 1930. The file was never reopened. The very fact that defendant during the ensuing 19 years made no further application for a permit to build the dam should have been sufficient indication to anyone making inquiry that the project had been abandoned so far as defendant was concerned \* \* \*. (R. 248-249)

"\* \* \* In the present case, plaintiffs' action is based upon an oral contract alleged to have been made in 1913, and they did not commence the action until 1952, eight years after all of the individuals whom they claim acted for the defendant corporation in making the contract had died. The plaintiffs, according to the allegations of their own pleading, did not make a formal written demand upon the defendant for the performance of the oral contract until 1951, many years after the last survivor of defendant's potential witnesses regarding the oral agreement had passed away. It is difficult to imagine a litigant being put to more serious disadvantage than to be called upon to defend against an eight and one-half million dollar lawsuit based upon a 39-year-old oral contract, when the only witnesses who could possibly testify in behalf of the defendant as to whether or not the contract was actually made, and, if so, as to what were its terms and conditions, have been dead for eight years or more." (R. 252)

ican Power & Light Company (R. 9).

(b) From May 1917 until November 1935 American Power & Light Company was wholly under the domination of Electric Bond and Share Company (R. 9).

(c) Electric Bond and Share Company was 100% wholly-owned by General Electric Company from 1905 to 1925 (R. 8).

It further shows (d): "Soon after 1925 General Electric Company distributed the Electric Bond and Share common stock among the stockholders of General Electric Company" (R. 8).

The record also contains references by counsel for plaintiffs to SEC Volume XI which shows that General Electric had disposed of all of its investment in Electric Bond and Share in 1925.

**C. The District Court Properly Determined That There Was No Genuine Issue as to Any Material Fact.**

On this appeal plaintiffs rely upon the allegations in paragraphs XXI to XXIV (quoted in full at pages 21 to 23 above) of the second amended complaint which were denied by the answer. Plaintiffs claim that because of these allegations there is a genuine issue as to the facts material to the defenses of limitations and laches. Paragraphs XXI to XXIII of the second amended complaint allege matters which all occurred at or before 1925 and do not contain allegations with respect to matters occurring in the following 27 years prior to the commencement of the action. Paragraph XXIV, however, alleges generally that "at all times" the defendant "advised and assured" plaintiffs that it "still proposed and intended" to perform its part of the oral contract and that plaintiffs relied on such advice and assurances.

It appears to be the contention of plaintiffs that under these pleadings, (a) plaintiffs are "entitled to submit evidence" at trial in support of the general allegations in paragraph XXIV and (b) such *right* to submit evidence creates a genuine issue of material fact (Appellants' Brief at page 23). Upon this basis plaintiffs assert the right to force defendant to a trial for breach of a 39-year-old oral contract long after the death of all potential witnesses to its existence or non-existence.

The want of merit in plaintiffs' contention is manifest when it is examined in the context of the purpose of Rule 56 and the record before the District Court.

**1. THE DETERMINATION OF THE DISTRICT COURT IS FOUNDED UPON THE EXPRESS PURPOSE OF RULE 56.**

Plaintiffs' contention that it would be *entitled* to submit evidence, if such evidence could be found, begs the question and seeks to ignore the purpose of Rule 56. The issue before

the District Court was whether there was a genuine dispute of material fact — whether any evidence actually existed which could be adduced at the trial to change the result—not the breadth of the issues framed by the pleadings. It is the purpose of Rule 56 to penetrate the formal allegations in the pleadings, reach the merits of the controversy, and determine whether evidence actually exists which could be adduced at the trial to create a genuine issue of material fact.<sup>34</sup>

Here the defendant moved for summary judgment on the ground of limitations and laches and specified evidence which of itself established all the facts material to those defenses, namely, that defendant had breached the alleged oral contract and made clear by its acts and conduct that its part of the alleged oral contract would not be performed but had been abandoned long before the commencement of the action. Such showing squarely raised the issue whether any evidence actually existed which could change the result. It called for specification of plaintiffs' actual evidence on the issue. The issue was never met by plaintiffs. The ruling which this Court has adopted from the Second Circuit is fully applicable to the case at bar:

“When a party presents evidence on which, taken by itself, it would be entitled to a directed verdict if believed, and which the opposite party does not discredit as dishonest, it rests upon that party at least to specify some opposing evidence which it can adduce and which will change the result.”<sup>35</sup>

If the rule were otherwise and if these plaintiffs could stand upon the general allegations of the pleadings without specifying evidence on which the Court could reach a rational

34. See authorities cited under Section III A, pages 30 to 35, above.

35. *Radio City Music Hall Corporation v. U. S.*, 135 F.2d 715 (Cir. 2, 1943) at 718, quoted with approval in *Byrnes v. Mutual Life Insurance Company of New York*, supra, fn. 20 at 501.

determination that there was a genuine issue of material fact, the remedy of summary judgment "would be a nullity."<sup>36</sup>

**2. THE DETERMINATION THAT THERE WAS NO GENUINE ISSUE OF MATERIAL FACT IS SUPPORTED BY THE ENTIRE RECORD BEFORE THE DISTRICT COURT.**

Plaintiffs filed three affidavits:<sup>37</sup> the first and second in opposition to the renewed motion to dismiss (which the District Court originally intended to treat as a motion for summary judgment) on the grounds that the claims were barred by the statute of limitations and laches; and the third in support of plaintiffs' motion to adjourn the hearing on motion for summary judgment on the ground that there were material facts requiring trial.

These lengthy affidavits, occupying 31 pages of the record on appeal, state that there is a "mass of connecting evidence" and a "vast amount of evidence," but to the extent any evidence is specified, it relates only to occurrences twenty-seven years or more before the commencement of the action. The third affidavit simply asserts that there are disputed facts, outlines the allegations of the complaint which are denied by the answer, and concludes with the statement that the plaintiffs desire a trial.

A review of the verified complaint, the amended complaint and the transcript of the argument of plaintiffs' counsel to the District Court (at the hearing on the motion to dismiss) also shows them to be devoid of any specification of any matter which could be adduced at the trial to "change the result" reached by the District Court. In addition

36. *Lindsey v. Leavy*, supra fn. 26, at 902.

37. A fourth affidavit, not relevant here, was filed by Milton Dam apparently after receiving a notice from District Court which is not in the record on appeal (R. 135).

(a) The original verified complaint, which consisted of 87 numbered paragraphs of detailed allegations, contained no allegation relating to the "advice and assurances" generally alleged in Paragraph XXIV of the second amended complaint.

(b) The evolution of the pleadings, from the verified complaint to the second amended complaint, exposes the intent of plaintiffs to tailor the pleadings so as to avoid the defenses of limitations and laches.<sup>38</sup>

(c) The defendant, by two motions to dismiss, by oral arguments and by motion for summary judgment, repeatedly raised the defenses of limitations and laches. Yet plaintiffs' counsel, though fully apprised of these issues, never once referred to any specific evidence which actually existed and which could be adduced at the trial in support of the general allegations of Paragraph XXIV of the second amended complaint.

The conclusion is inescapable that the allegations in Paragraph XXIV are formal and "insufficient to state a justiciable controversy requiring the submission thereof for trial."<sup>39</sup> We submit that the District Court was manifestly correct when it determined on this record that there was no genuine issue as to any material fact.

#### **D. The Material Facts as to Which There Is No Genuine Issue Entitled Defendant to Judgment as a Matter of Law.**

##### **1. THE APPLICABLE LAW WAS THAT OF THE STATE OF WASHINGTON.**

The jurisdiction of the District Court was based on diversity of citizenship and the applicable law of limita-

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38. See *Kowalewski v. City of Hastings*, supra, fn. 26, at 827 and 828.

39. *Zampos v. United States Smelting Refining and Min. Co.*, supra, fn. 26 at 173, 174.

tions and laches therefore was that of the forum,<sup>40</sup> the State of Washington.

## **2. THE ACTION IS BARRED BY THE STATUTE OF LIMITATIONS AS APPLIED IN WASHINGTON.**

The statutes of Washington prescribe a limitations period of three years in actions "upon a contract or liability, express or implied, which is not in writing, and does not arise out of any written instrument."<sup>41</sup> This three-year period of limitations is expressly applicable to plaintiffs' first cause of action and has been construed unequivocally as applicable to the second cause of action for unjust enrichment.<sup>42</sup>

The District Court held that "the right of action on both causes of action accrued when defendant breached the contract and made it clear by its acts and conduct that its part of the contract would not be performed" (R. 248). This rule was applicable whatever the relationship of the parties under the oral contract.<sup>43</sup> Accordingly, the District Court's decision on the material facts was correct under the applicable law of the State of Washington.

## **3. THE ACTION IS BARRED BY THE DOCTRINE OF LACHES AS IT HAS BEEN APPLIED IN WASHINGTON.**

The District Court properly held that neither of the alleged causes of action was equitable (R. 247, 248). In addi-

40. For a recent case applying this rule see *Beehler v. Kaye*, 222 F.2d 216 (Cir. 10, 1955).

41. Section 4.16.080 subd. (3), Revised Code of Washington.

42. *Halver v. Welle*, 44 Wn. 2d 288, 266 P.2d 1053 (1954); *Geranios v. Annex Investments*, 45 Wn. 2d 233, 273 P.2d 793 (1954).

43. Even in cases where the relationship of the parties is of a fiduciary nature the statute begins to run as soon as the plaintiff has knowledge of the repudiation. See *Arneman v. Arneman*, 43 Wash. 2d 787, 264 P.2d 256 (1953) at 264 P.2d 262 (resulting trust); *Corliss v. Hartge*, 180 Wash. 685, 42 P.2d 44 (attorney and client).

tion in Washington the statute of limitations is applicable to both legal and equitable rights.<sup>44</sup> The plaintiffs argued, however, that their case was unusual, calling for the application of equitable principles. Therefore the Court considered the doctrine of laches and held that recovery was precluded under that doctrine also.

The holding of the District Court was clearly a correct application to this case of the doctrine of laches as it has been applied in the State of Washington.<sup>45</sup>

#### **E. The Points Raised in Plaintiffs' Specifications of Errors Are Without Merit.**

##### **1. THE ALLEGED ERROR IN STRIKING PLAINTIFFS' MOTION FOR ADJOURNMENT OF HEARING ON MOTION FOR SUMMARY JUDGMENT.**

Plaintiffs assert there was error in striking from the record their Motion for Adjournment of Hearing on Summary Judgment Motion.

The District Court acted correctly in striking the motion for adjournment because Rule 56 grants to a party moving for summary judgment the right of an inquiry into the merits to determine if there are genuine issues of fact just so that the expense and hardship of trial can be avoided if there are no such issues. If it had done otherwise, the District Court would have erred in not following the plain mandate of Rule 56.

Further, when plaintiffs asserted in support of their motion that the hearing should be postponed because there were genuine issues of fact requiring trial, they were merely presenting the "crucial question before the court on the summary judgment motion; namely, as to each affirmative defense alleged by defendant, [was] there a genuine issue

44. See *Arneman v. Arneman*, supra, fn. 43 at 264 P.2d 262.

45. *Teeeter v. Brown*, 130 Wash. 506, 228 Pac. 291 (1924); *Kilbourne v. Kilbourne*, 156 Wash. 439, 287 Pac. 41 (1930).

of material fact?" (R. 236) If there had been such an issue, the motion for summary judgment would have been denied (R. 236).

## **2. THE ALLEGED ERROR IN GRANTING THE MOTION FOR SUMMARY JUDGMENT.**

This specification of error contains seven separate grounds. In some instances it is not clear from plaintiff's brief exactly what is claimed as error, but an attempt is made to discuss each ground as best as it can be understood.

(1) Plaintiffs contend: The defense of laches and the statute of limitations are affirmative defenses, either of which must be established "after a full hearing on testimony by both parties."

If plaintiffs are stating here that summary judgment cannot be granted on the grounds of limitations and laches, they are stating a proposition that has been rejected by the courts. Summary judgments on the grounds of limitations or laches have been upheld in three cases decided in this circuit alone.<sup>46</sup>

(2) Plaintiffs contend: No date can definitely be determined from the pleadings depositions, admissions on file, or affidavits when plaintiffs can be charged with laches or when the statute of limitations commenced to run.

The fact that "plaintiffs' causes of action must have accrued more than three years prior to July 16, 1952" is the very fact as to which the District Court determined there was no genuine issue. See discussion at pp. 35 to 38 above.

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46. *Suckow Borax Mines Consol. v. Borax Consolidated*, supra fn. 14; *Burnham Chemical Co. v. Borax Consolidated*, 170 F.2d 569 (Cir. 9, 1948); *Latta v. Western Inv. Co.*, 173 F.2d 99 (Cir. 9, 1949). See also *Gifford v. Travelers Protective Ass'n.*, supra fn. 31, upholding a summary judgment granted on the ground that an action had not been brought on an insurance contract within the six-month period specified in the agreement.

(3) Plaintiffs contend: The parties entered into a "Joint Venture Agreement" and "without a full hearing on testimony by both parties it cannot be determined as a matter of law that each party to such agreement fulfilled such obligations."

There is nothing in this asserted ground that is inconsistent with the District Court's ruling.

For the purposes of the motion it was admitted that the alleged oral contract had been made and had been performed by plaintiffs. In addition, from plaintiffs' pleadings and from the uncontested affidavits of defendant, it was undisputed that defendant had breached and abandoned such alleged oral contract, to the plaintiffs' knowledge, more than three years before the commencement of this action. See discussion at pp. 35 to 38 above.

(4) Plaintiffs contend: "The relationship of the parties, being based on a bilateral contract, can be rescinded, abrogated, abandoned or terminated only by mutual consent or the accomplishment of the objects of the joint venture agreement, and if otherwise terminated each party must put the other in *status quo*."

Again there is nothing asserted which is inconsistent with the ruling of the District Court. Plaintiffs simply omit to mention that their causes of action arose more than three years before the commencement of the action and are barred by limitations and laches.

(5) Plaintiffs contend: "There is nothing in the record presented to the trial court from which it can be determined, either as a matter of law or as a fact, that the appellee has suffered any disadvantage or detriment by the delay" in commencing the action.

This ground relates to the alternate holding that the action is barred by laches. The District Court held that plain-

tiffs' causes of action were barred by limitations. It considered the defense of laches on the insistence of plaintiffs that their case was an unusual one, requiring the application of equitable principles. The District Court, in holding that the causes of action also would be barred by laches, was correct for the reason that it stated so succinctly:

"It is difficult to imagine a litigant being put to more serious disadvantage than to be called upon to defend against an eight and one-half million dollar law suit based upon a 39-year-old oral contract, when the only witnesses who could possibly testify in behalf of the defendant as to whether or not the contract was actually made, and, if so, as to what were its terms and conditions, have been dead for eight years or more." (R. 252)

(6) Plaintiffs contend: The affidavits submitted by the defendant purporting to support its motion for summary judgment do not conform with Rule 56(e) requiring personal knowledge.

In the affidavits submitted in support of the motion, the affiants state by direct allegations the facts contained therein and support them in the case of the affidavits dealing with the records of the Federal Power Commission and the Secretary of State of the State of Washington, with documents in proper form to be admissible in evidence.

(7) Plaintiffs contend: It appears from the complaint, and is not denied by defendant, that the defendant at all times prior to the commencement of this action led the plaintiffs to believe its purpose and intention was to perform its part of the joint venture agreement, and there was therefore a genuine issue of material fact presented by the record.

This is exactly the issue raised by the motion for summary judgment. Defendant established, and the District

Court determined, that defendant had breached the alleged agreement and made clear to plaintiffs by its acts and conduct that its part of the alleged agreement would not be performed more than three years before the commencement of the action. The plaintiffs never met the issue thus raised. The District Court's determination that there was no genuine issue of material fact is manifestly correct on the record. See discussion at pp. 39 to 42 above.

## IV.

### **CONCLUSION**

This case is a clear example of the wisdom of providing for summary judgments in the Federal Rules. This Court knows that summary judgment would not have been granted by the District Court if there had been any basis in the record for concluding that plaintiffs could adduce evidence which would "change the result" of the uncontested evidence presented by defendant in support of the motion for summary judgment. It is this fact that plaintiffs seek to avoid—for the reason that there is no such evidence. The judgment should be affirmed.

Respectfully submitted,

WILLIAM W. GODWARD  
EDWIN E. HUDDLESON, JR.  
JOHN H. WALLACE  
COOLEY, CROWLEY, GAITHER,  
GODWARD, CASTRO & HUDDLESON,  
333 Montgomery Street,  
San Francisco 4, California,

PHILIP S. BROOKE  
HAMBLEN, GILBERT & BROOKE  
Paulsen Building  
Spokane 1, Washington

*Attorneys for Appellee.*

No. 15395

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IN THE  
**United States  
Court of Appeals  
FOR THE NINTH CIRCUIT**

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MILTON E. DAM AND EVERETT S. DAM,  
Co-partners doing business under  
the Firm Name and Style of  
DAM BROTHERS,

*Appellants,*

vs.

GENERAL ELECTRIC COMPANY,  
a corporation,

*Appellee.*

---

*Appeal from the United States District Court  
for the Eastern District of Washington,  
Northern Division*

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BRIEF OF APPELLANTS

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PHIPPS & PHIPPS,  
HARVE H. PHIPPS, SR.  
HARVE H. PHIPPS, JR.  
314 Columbia Building,  
Spokane 4, Washington,  
*Attorneys for Appellants.*



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## JURISDICTIONAL STATEMENT

(NOTE: The bracket reference numbers [ ] refer to the printed Transcript of Record.)

The jurisdiction of the District Court of the United States for the District of Washington, Northern division, was invoked pursuant to the provisions of Title 28, United States Code, Section 1332, the appellants being partners and residing in the state of Washington and the appellee being a corporation organized and existing under the laws of the state of New York. [96-97]. The amount in controversy exceeds the sum of \$3,000.00, exclusive of interest and costs.

The jurisdiction of this court to review this case arises under Title 28, United States Code, Sections 1291 and 1294, this being an appeal from a final decision of a District Court from which an appeal may be taken.

In addition, the appellee by its motion for summary judgment invoked the jurisdiction of the District Court, and the District Court assumed jurisdiction and entered summary judgment on such motion.

## STATEMENT OF THE CASE

There is a historical background to this case outlined in the Second Amended Complaint (which for brevity will hereafter be referred to as the "complaint" as distinguished from the "Original Complaint" and the "First Amended Complaint" which will be referred to as "Original" and "First Amended" complaints,) which background should be considered in connection with the issues on this appeal.

The general locale of the action is the Columbia river, the headwaters of which are in Montana and flows northerly into Canada and makes a horse-shoe loop and enters the state of Washington near the northeast corner of that state and flows westerly and southerly through Washington to its junction with the Snake river and thence westerly to the Pacific ocean; the particular locale is the general area where the Columbia is adjacent to the westerly end of the Saddle mountains called the Priest Rapids of the Columbia, easterly from the Columbia and southerly from the Saddle mountains, generally called the Wahluke Slope, and the irrigable lands in that territory.

Appellants are brothers whose parents settled on lands adjacent to Priest Rapids and were born and raised in that vicinity and knew the country and its potentialities, particularly along agricultural lines,

if irrigated, and had worked out a system for irrigating lands of the Wahluke Slope, diverting water from the Columbia at Priest Rapids and carrying it through ditches eastward and southward to and upon the Wahluke Slope. This system contemplated a wing dam to divert the water but did not require bridging the Columbia from bank to bank. Appellants had advanced the project to where they controlled some one hundred fifty thousand acres of irrigable lands in 1910 and before. Appellants were principally interested in an agricultural irrigation development.

Appellee's interest was in developing electrical energy and the Columbia, at Priest Rapids, was suited for such purpose, but an electric power project required damming the river from bank to bank and controlling the flow of the water through turbines to generate electricity, before diverting the same to the lands for irrigation purposes.

Combining their interests for the development of electrical power and the use of water for irrigation purposes, the parties worked out plans for the development of Priest Rapids for both power and irrigation and in the year 1913 entered into the joint venture agreement outlined in paragraphs XV to XV $\frac{1}{2}$  [108-113] of the complaint, both sides to per-

form duties and obligations and reap benefits, all as set out in the complaint, but in the accomplishment of which certain Congressional legislation was required, for the passage of which the voting support of the landowners controlled by the appellants was required.

Appellants entered upon the joint venture agreement and through their influence and efforts promoted the required legislation and gave their active lives in making the project possible and fully performed on their part the joint venture agreement. The legislation accomplished vast potentialities to the appellee, not alone in connection with the Priest Rapids project but in the development of electrical energy on navigable and other streams all over the United States. The appellee entered upon a vast development of electrical power projects all over the country, some two hundred thirty-five in number, and capitalized upon and benefited through the work and efforts of the appellants and became the world's leader in producing electrical energy and in manufacturing electrical appliances, but at all times demonstrating to appellants that the Priest Rapids project was to be developed as originally planned and the appellants would reap the benefits promised under the joint venture agreement.

It is the appellants' position that through the actions of the appellee and the subsidiary corporations controlled by it, an enormous hoax or fraud was perpetrated and the appellants and their interest were by-passed. They had no knowledge nor intimation of what was occurring and nothing upon which to base a belief that the appellee was not acting in the utmost good faith required of a joint venturer with and toward the other, until immediately prior to instituting this action.

Upon the institution of this action the appellee exhibited an "about-face" attitude and has employed every tactic and device to defeat appellants' claims or in any way to compensate appellants for devoting their active lives to the cumulation of the joint venture agreement, but on its part the appellee has reaped and retained all of the benefits and riches resulting to it as the benefits conferred upon it through the appellants' performance of the joint venture agreement.

Appellants' position is that they have been treated unjustly and inequitably, and are asking that the appellant be compelled to do what is right and equitable so far as these appellants are concerned.

Although this action was instituted in July, 1952, [3-44] it was not until August, 1956, that summary judgment [255] was entered against appellants, through no fault of appellants. If laches existed as found by the court, it existed four years before the finding of laches.

In its opinion rendered in connection with the motion for summary judgment, the trial court said: [247]

"Moreover, one of the principal objects of the contract was the construction of a dam across the Columbia River at the Priest Rapids site for the generation of electrical energy, and *the court will take judicial notice* that a permit for the building of such a dam at the same site has been issued by the Federal Power Commission to the Grant County Public Utility District, and at least preliminary work on the project has been commenced."

For the conveyance or surrender to the Grant County Public Utility District of water and other rights along both banks of the Columbia at said site for approximately twenty-five miles, acquired by the appellee and its subsidiary corporations for it, through and as the results of the efforts and performance of the joint venture agreement, there has been allocated to the appellee and its subsidiaries and municipal corporations the following percentages of the electrical energy to be produced by such project, to-wit:

<i>Agency</i>	<i>Percentages</i>	<i>Kilowatts</i>
Pacific Power & Light Co.	13.9	87,570
Portland General Electric Co.	13.9	87,570
Puget Sound Power & Light Co.	8.0	50,400
Seattle City Light	8.0	50,400
Tacoma City Light	8.0	50,400
Washington Water Power Co.	6.1	38,430
Cowlitz County PUD	2.0	12,600
City of Eugene, Oregon	1.7	10,710
City of Forest Grove, Oregon	0.5	3,150
City of McMinnville, Oregon	0.5	3,150
City of Milton-Freewater, Oregon	0.5	3,150
Kittitas County PUD	0.4	2,520
Grant County PUD	36.5	229,950

In other words, while there has been allocated to the Grant County PUD 36.5% of the electrical power to be produced, the appellee and its subsidiaries has been allocated 41.9%, without recognizing any rights of the appellees under the joint venture agreement or compensating them.

## SPECIFICATION OF ERRORS

### I

The court erred in summarily, and of its own motion without any hearing, denying appellants' Motion for Adjournment of Hearing on Summary Judgment Motion [221-2], and in entering its Order Striking Motion for Adjournment of Hearing on Summary Judgment Motion [234].

### II

The court erred in granting appellee's Motion for Summary Judgment [255] in favor of the appellee, on each and all of the following grounds:

First. Under RULE 8(c) the defenses of laches and of the statute of limitations are affirmative defenses, either of which must be established after a full hearing on testimony by both parties, and the appellee has the burden of establishing either defense by a preponderance of the evidence;

Second. No date can be definitely determined from the pleadings, depositions, admissions on file, or affidavits, when the appellants can be charged with laches, or when the statute of limitations commenced to run;

Third. Under the allegations of the complaint (XV-XVII) [108-114], the parties entered into a joint

venture agreement, which allegations, for the purpose of the motion, are to be taken as true, and the rights of the parties determined under rules relating to joint adventurers. A fundamental principle underlying such relationship is that each party owes to the other the utmost good faith in all their dealings relating to such joint venture, and without a full hearing on testimony by both parties, it cannot be determined *as a matter of law*, that each party to such agreement fulfilled such obligations.

Fourth. The relationship of the parties, being based on a bilateral contract, can be rescinded, abrogated, abandoned or terminated *only* by mutual consent or the accomplishment of the objects of the joint venture agreement, and if otherwise terminated each party must put the other in *status quo*, and it appearing from the complaint that appellants on their part have fully performed, and have not been compensated, it is unjust and inequitable for the court to render summary judgment for the appellee without giving to appellants their day in court or an opportunity to establish their rights;

Fifth. At least two elements must exist before the doctrine of laches comes into operation, to-wit, (a) unreasonable delay in asserting rights, and (b) such delay has worked to the detriment or disadvantage of the other, so that it would be unjust or inequitable

to enforce such rights, and there is nothing in the record presented to the trial court from which it can be determined, either as a matter of law or as a fact, that the appellee has suffered any disadvantage or detriment by the delay. The burden of proof to establish the elements of laches is on the appellee and the appellee has not sustained such burden;

Sixth. The affidavits submitted by the appellee, purporting to support its motion for summary judgment, do not conform with RULE 56(e), requiring personal knowledge;

Seventh. It appears from the complaint, and is not denied by the appellee, that the appellee at all times prior to the commencement of this action lead the appellants to believe that its purpose and intention was to perform its part of the joint venture agreement, and intention was to perform its part of the joint venture agreement, and appellee deceived and concealed from the appellants its purpose and intention not to perform its part of such joint venture agreement, and circumstances exist in this case which excuse the appellants' delay, and render it unjust and inequitable to interpose the bar of laches or statute of limitations, and the appellee is estopped to rely on such defense, and the facts and circumstances excusing such delay cannot be determined as a matter of law, without evidence, or based on speculation or

conjecture, and there was a genuine issue of material fact presented by the record in this case, which precludes the trial court from entering a valid summary judgment.

## ARGUMENT

## SPECIFICATION OF ERROR No. I

Simultaneously with the service of its answer [204] the appellee served its Motion for Summary Judgment [220]. Upon service of such motion the appellants served and filed their Motion for Adjournment of Hearing on Summary Judgment Motion [221] based upon the records and files including the affidavit of Harve H. Phipps, Sr. [222].

Forthwith the trial judge, of its own motion and without any hearing, entered its Order Striking Motion for Adjournment on Summary Judgment Motion [234], and entered its Order Granting Motion for Summary Judgment [254], without any hearing, and rendered its Summary Judgment [255] in favor of the appellee. In his letter of August 8th, 1956, [236] the trial judge attempted to justify his action with reference to entering the order striking appellants motion for adjournment with the statement that "there is not provision in the rules for such a motion."

RULE 1 provides that "They (Federal Rules of Civil Procedure) shall be *construed* to secure the *just, speedy* and *inexpensive* determination of every action.

RULE 56(c) provides, with reference to motions for summary judgment that "the judgment sought

shall be rendered forthwith *if* the pleadings, depositions and admissions on file, together with the affidavits, if any, *show that there is no genuine issue as to any material fact* and that the moving party is entitled to judgment *as a matter of law*''.

The affidavit of Harve H. Phipps, Sr., [222] specifies at least 29 instances where the answer of the appellee presents genuine issues of material facts, but, notwithstanding, the trial judge summarily ordered the motion stricken and refused to delay the motion for summary judgment until proof could be submitted on such issuable facts. Appellants contend that such action on the part of the trial court was prejudicial error.

In *National Surety Co. v. Rollins*, 16 F.R.D. 530 (syl. 1-2) the court said:

“On motion for summary judgment, the court is precluded from making any determination of the factual issues. If, in reading of the pleadings, depositions, and affidavits, which comprise the paper record a genuine issue of fact is encountered, the court need go no further; *indeed it is prevented from proceeding further*. Mere existence of a material fact is both the sought-after feature and the limiting element of a court’s disposition of the motion”.

In *Aetna Insurance Co., v. Cooper Wells Co.*, 234 F. 2d. 342, it is held that the function of a motion for summary judgment is not to permit the court to

decide issues of fact but solely to determine whether there are issues of fact to be tried.

In *Brinich v. Reading Co.*, 9 F.R.D. 420, it is held that where the defendant in its answer pleaded affirmative defenses, no reply by plaintiff is mandatory and facts alleged in new matter must be taken as denied, thereby presenting material issues of fact, precluding summary judgment.

On motion for summary judgment allegations of the complaint would be taken as true. *Engel v. U.S.*, 138 F. Supp. 626; *Schwob v. International Water Corp.* 136 F. Supp. 310; *Robinson v. U.S.*, 133 F. Supp. 9; *Coy v. Hobby*, 129 F. Supp. 640; *Jeffrey v. Whitworth College* (D.C. Wash.) 128 F. Supp. 219; *Smart v. U.S.*, 111 F. Supp. 907.

#### SPECIFICATION OF ERROR No. II

First. RULE 8(c) requires that the defense of either laches or the statute of limitation be pleaded as an affirmative defense, and under all rules of procedure a party asserting an affirmative defense has the burden of establishing such defense by a preponderance of substantial evidence, and the same cannot be determined by resort to speculation or conjecture.

Prejudice must exist to establish the defense of laches, it cannot be presumed, and defense of laches or estoppel are affirmative defenses which call for a

full hearing of testimony on both sides. *Jas. McWilliams Blue Lines, Inc. v. Esso Standard Oil Co.*, 145 F. Supp. 392; *Baker v. Nason*, 236 F. 2d. 483; *Potash Co. of America v. International Minerals & Chemical Co.*, 213 F. 2d. 153.

On motion for summary judgment, it is not the court's function to decide issues of fact but solely to determine whether there is an issue of fact to be tried. *Pickle v. Trimmel*, 93 F. Supp. 823; *Kasper v. Baron*, 191 F. 2d. 737.

Second. It is fundamental that before the statute of limitations commences to run, or a party can be charged with laches for delay in instituting an action, the claim must have "matured", that is, the cause of action must have been ready for suit. The relationship of the parties and their association extended over a long period of time before this action was instituted, but there cannot be read into such relationship or association any definite date or time when either party to the joint venture agreement, particularly the appellee, performed any act or took any action, up to the time immediately prior to the institution of this action, it was brought to the attention of appellants that the appellee was taking steps inconsistent with the purposes of the joint venture agreement, and this action was instituted within a reasonable time thereafter.

Paragraphs XXI to XXIII, inclusive of the complaint [116-118] sets forth facts to excuse appellants' delay in bringing this action, which paragraphs are denied in appellee's answer [209] thereby creating an issue of material fact which would preclude the granting of a summary judgment, but further than this the issue is presented that through fraud, deception, concealment, misrepresentation, the appellee at all times prior to the commencement of this action induced the appellants into a false sense of security and to believe that it was the purpose and intention of the appellee to perform its obligations under the joint venture agreement.

It is held in *Central Ry. Signal Co. v. Longden*, 194 F. 2d. 310, that there must be knowledge before there can be laches and there can be no laches where delay is caused or induced by fraud or concealment, and that a party is not guilty of acquiescence if he is without knowledge of fraud, or where the existence of fraud is concealed from him. There is another principle applicable to the situation in this case and that is that where one party has been misled by the acts and actions of another which have lulled him into a false sense of security, the party so misleading or creating such condition is estopped to assert delay caused thereby as a defense.

In *Hichino Uyeno v. Atchenson*, (D.C. Wash.) 96 F. Supp. 510, it is held to be a fundamental rule of

equity jurisprudence that he who prevents the exercise of rights by another, cannot insist that that right was lost during the period in which its exercise was prevented by him.

In this connection see *Holmberg v. Armbrecht*, 327 U.S. 392, 90 L. ed. 743, 66 S. Ct. 582, 162 A.L.R. 719; *Potash Co. of America v. International Min. & Chem. Corp.* 213 F. 2d. 153; *Dexter & Carpenter v. Houston*, 20 F. (2d) 647.

Third. Appellants' rights are based on a joint venture agreement under which appellants have fully performed all of their obligations, while this action was instituted as an action to enforce specific performance on the part of the appellee, or, if performance prove impossible to equitably compensate the appellants for the benefits conferred as the result of appellants' performance of the joint venture agreement.

The duties and obligations of joint adventurers to each other are expressed in the Washington case of *Donaldson v. Greenwood*, 242 P(2d) 1038, citing with approval and quoting from *Meinhard v. Salmon*, 164 N.E. 545, as follows:

"Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at

arm's length are forbidden by those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor most sensitive, is the standard of behavior. As to this there has been developed a tradition that is unbending and inveterate".

To the same effect see 48 C.J.S. 824-27 (Joint Adventurers, Sec. 5(b), and *Eagle Picher Co. v. Mid-Continent Lead & Zinc Co.* 209 F. 2d. 917; *Taylor v. Brindley*, 164 F. 2d. 235; *Plews v. Burrage*, 19 F(2d) 412; *Hey v. Duncan*, 13 F. 2d. 794.

Under the allegations of the complaint, which for the purpose of this motion must be accepted as true, no other conclusion can be reached than that from the full performance of the joint venture agreement by appellants, the appellee has reaped, whether justly or unjustly, untold benefits, and whether under the theory of implied agreement to compensate the appellants for such benefits, or under the theory of unjust enrichment, the trial court erred in granting summary judgment thereby depriving appellants of their day in court and their right to equitable relief, and summarily "booting" them out of court on a motion for summary judgment.

By its action the trial court has violated not only the letter but the spirit of RULE 1 that "They (the rules) shall be construed to secure the *just, speedy*

and *inexpensive* determination of every action". None of these elements have been accomplished by the action of the trial court. *Justice* has been raped, the trial of the action has been delayed, and the appellants have been delayed for an inestimable time in coming to this court to obtain their day in court, and have been put to an enormous expense. Every purpose contemplated by RULE 1 has been sacrificed.

Fourth. This action being based on a bilateral contract for a joint adventure, with obligations to be performed and benefits to accrue to each party, and the appellants having performed all of the obligations on their part to be performed from which performance on the part of appellants the appellee has reaped its benefits but the appellee has failed to perform its obligations so as to permit the appellants to enjoy the benefits anticipated by them ,the objects of the joint venture agreement not having been attained and there being no *mutual* rescission or abandonment of the joint venture, justice and equity requires that appellee be required to perform its obligations under the contract, or if such performance cannot be had, adequate compensation be compelled from it to appellants in lieu of such performance, and the determination of the terms and conditions of a just, proper and equitable decree to be issued under the facts in this case must be based on substantial evidence after a full hearing.

The appellee, after receiving the benefits of the joint venture agreement, cannot rescind or abandon the agreement, without placing the appellants *in status quo*, or as nearly as possible to do so, or compensating the appellants for the advantages, benefits and riches acquired by it, as the result of the performance on the part of appellants.

As stated in *Rubenstein v. Dr. Pepper Co.*, 228 F. 2d. 528:

"A party may not have rescission of a contract where he affirms and retains benefits of a contract and seeks only to *disaffirm its obligations*".

and in the case of *May v. Rice*, 118 F. Supp. 331, it is held that rescission means not only the annulment or abrogation of a contract, but the placing of the parties *in status quo*, and implies restoration to the same situation and the same terms as existed when the contract was made, and requires surrender of any consideration or advantage secured by either party, or an offer to restore.

The nature of this action being equitable and the court having jurisdiction, the trial court should have retained jurisdiction of the action until a fair, just and equitable decree was entered, after a full hearing, and not summarily enter judgment denying equitable relief, and if the fair, just and equitable dis-

position of the case requires a money judgment to compensate appellants for the unjust enrichment and benefits received by the appellee, then such form of money judgment should be rendered and entered.

Fifth. Before it can be determined, *as a matter of fact*, that appellants' claims are barred, it must be established as a fact, beyond the realm of speculation or conjecture that appellants delayed bringing this action an unreasonable length of time after the claims "matured" or were ready for suit, and that by reason of such delay the other party, appellee, has suffered detriment or been damaged, so that it would be unjust or inequitable to enforce such claims.

A reading of the complaint [122] clearly establishes that instead of being damaged or suffering detriment by the delay, the appellee has been benefitted and enriched, and is reaping benefits, and will continue to do so, as evidenced by the statement of the case at the beginning of this brief where it is demonstrated that the appellee and its subsidiary corporations has a 41.9% allotment of the power to be developed by the Grant County Public Utility District.

*In re National Moulding Co.* 230 F. 2d. 69;  
*Baker v. Nason*, 236 F. 2d. 483 (supra).

Sixth. RULE 56(e) requires affidavits submitted in support of a motion for summary judgment be made

on *personal knowledge*. It is submitted that none of the affidavits submitted are made on personal knowledge nor do they submit any facts from which it can be determined that the appellee has suffered any detriment or damage directly attributable to the delay in bringing the action, nor do they set up any material facts to support appellee's motion for summary judgment.

A mere reading of the record in this case clearly shows that the trial court's decision was not based upon anything other than guess, speculation or conjecture and the summary judgment entered in this case was improperly and improvidently entered.

Seventh. Under the issues raised by the complaint and the answer of the appellee, the appellants are entitled to submit evidence that at all times immediately prior to the commencement of this action the appellee lead appellants to believe that it was its purpose and intention to develop both the electrical power potentialities and the irrigation possibilities to be obtained through the development of the Priest Rapids project, and it was not until the appellee and the subsidiaries controlled by and operating under it commenced selling off the irrigable lands, retaining however the water rights and power sites, did appellants discover that appellee's purposes and intentions might be otherwise. The entire project contemplated both the development of the irrigable agri-

cultural lands, which was the original purpose of appellants, and the development of the water power potentialities to generate electrical power, which was the original interest of the appellee, but under the circumstances one was dependent on the other, as alleged in the complaint.

The RULE authorizing summary judgment by its terms limits its application to cases where there is no genuine issue as to material facts, and its application leaves to discretion in the trial court, that is to say, if there is an issue the rule does not apply and the issue must be decided on evidence.

Summary judgment procedure is not intended to be a substitute for trial of cases where there are genuine issues of disputed facts on which the outcome of the litigation depends. *Griffeth v. Utah Power & Light Co.*, (C.A. Idaho) 226 F. 2d. 661. The purpose of the rule was not to require a party to try his case on affidavits, with no opportunity to cross-examine witnesses. *Dulansky v. Iowa-Illinois Gas & Electric Co.*, 191 F. 2d. 881.

Summary judgment should be invoked with caution to the end that litigants may be afforded a trial where a bona fide dispute of material facts exists between them. *Panaview Door & Window Co. v. Van Ness*, (D.C. Cal.) 135 F. Supp. 253. A motion for sum-

mary judgment should be considered with great care by trial judge. *Long v. Arkansas Foundary Co.*, 137 F. Supp. 835.

## CONCLUSION

There are genuine issues of material facts to be tried on evidence in this case, including the determination of the fact as to when the action matured or was ripe for suit and whether there was an unreasonable delay in bringing the action thereafter, and whether or not the appellee suffered damage, detriment or was prejudiced by reason of such delay so that it is unjust and inequitable to enforce the appellants demands at this time, and because of such issues, which can only be determined by evidence, RULE 56, permitting the entry of summary judgment, has no application to the record in this case, and the trial court erred both in striking appellants' motion to adjourn the hearing on the motion for summary judgment until such evidence could be presented, and in rendering and entering such summary judgment in the face of genuine issues of material facts, and that such summary judgment should be set aside and this case remanded for trial on the issues presented by the pleadings.

Respectfully submitted,

PHIPPS & PHIPPS

By HARVE H. PHIPPS,

314 Columbia Building,

Spokane 4, Washington,

*Attorneys for Appellants.*

No. 15395

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IN THE  
**United States  
Court of Appeals  
FOR THE NINTH CIRCUIT**

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MILTON E. DAM AND EVERETT S. DAM,  
Co-partners doing business under  
the Firm Name and Style of  
DAM BROTHERS,

*Appellants,*

vs.

GENERAL ELECTRIC COMPANY,  
a corporation,

*Appellee.*

---

*Appeal from the United States District Court  
for the Eastern District of Washington,  
Northern Division*

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**APPELLANTS' REPLY BRIEF**

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PHIPPS & PHIPPS,  
HARVE H. PHIPPS, SR.  
HARVE H. PHIPPS, JR.  
314 Columbia Building,  
Spokane 4, Washington,  
*Attorneys for Appellants.*

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SHAW & BORDEN CO. 320133

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IN THE  
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MILTON E. DAM AND EVERETT S. DAM,  
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APPELLANTS' REPLY BRIEF

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It is the appellants' firm belief that in their brief on this appeal they have honestly and faithfully presented to this court a full and fair statement of their claims and of the facts they will be able to establish, if given the opportunity, which will entitle them to equitable relief, and it is also the firm belief of the appellants that the appellee, in its brief, has conversely attempted to present to this court a misleading vision of the issues in this case, evidently on the false hope that through such expert and masterful evasive tactics this court will be led away from the real issues involved.

This is forceably illustrated by the fact that at the appellee's request and under its direction, there has been included in the first ninety-five pages of the record the original and first amended complaints and the various dilatory motions and pleas directed against such original and first amended complaints which were superseded by the second amended complaint upon and under which the motion for summary judgment was granted by the trial court. The inclusion of superseded and withdrawn pleadings and the proceedings had in the trial court thereon, all of which had become *functus officio*, has resulted in confusion and has encumbered the record unnecessarily.

In the case of *Nisbet v. Van Tuyl*, 224 F. (2d) 66, the court said:

"Upon a motion for summary judgment the court, in considering the pleadings upon which the motion is in part based, considers the amended pleadings rather than the prior pleadings superseded by the amended pleadings. An amended pleading ordinarily supersedes the prior pleading is in effect withdrawn as to all matters not restated in the amended pleading, and becomes *functus officio.*"

and in *Hutchins v. Priddy*, 103 Fed. Supp. 601, it is stated that:

"It is hornbook that an amended pleading which is complete in itself and does not refer to a prior pleading supersedes the prior pleading so that it no longer remains a part of the record in an action."

See also *Aetna Life Ins. Co. v. Phillips*, 69 F. (2d) 901.

And *Ericson v. Slomer*, 94 F. (2d) 437.

And *Herr v. Herr*, (Wash.) 211 P (2d) 710.

## APPELLEE'S ATTEMPTED EVASION OF MATERIAL ISSUES

The appellee in its brief has made a masterful attempt to mislead the court by evading the material issues raised by the record in this case, and to attempt to shift the responsibility to the appellants of trying this case upon affidavits or evidence aliunde the record.

In its argument, commencing on page 30 of its brief, the appellee defines the duty of the District court was "to pierce the formal allegations of the pleadings, reach the merits of the controversy, and determine whether there was any genuine issue as to any material fact". Without unduly extending this reply, the appellants suggest that the court consider the second amended complaint [96-124] and the appellee (defendant's) answer thereto [204-214] together with the affidavit of Harve H. Phipps, Sr. [222-234] submitted in support of appellants' motion for adjournment of hearing on the motion for summary judgment, in which affidavit there are at least twenty-nine specification of genuine issues of material fact all of which required a trial on evidence.

This court in the case of *Griffith v. Utah Power & Light Co.* 226 F. (2d) 661 (syl. 6-13, p. 669) set out the rules governing the duties of the trial courts in

matters of this kind, and if the rules there laid down are adhered to in this case the summary judgment of the trial court cannot be affirmed.

In this same connection the case of *Bruce Construction Corp. v. U. S.* for the use of *Westinghouse Electric Supply Co.* 242 F. (2d) 873 places the burden upon the movant for summary judgment to make "*out a convincing showing that genuine issues of fact are lacking*" before the courts will require that the adversary adequately demonstrate by receivable facts that a real, and not a formal, controversy exists.

In an evident attempt to make it appear that the appellee has been prejudiced by the delay in bringing this action the appellee bases an argument upon the fact that it appears that some of the principals, Coffin, Mitchell and Pierce have been dead for some years and possibly upon the affidavit of Roy H. Luebbe [169] "that a search of the General Electric Company record files was conducted. These record files of the General Electric Company are maintained in or near Schenectady, New York. I have been advised that this search failed to reveal any correspondence or other documents concerning the existence of the alleged joint venture between the Dam Brothers and the General Electric Company or its alleged agents." Whatever else may be said of this affidavit of Luebbe's, it certainly does not meet the

standards prescribed by RULE 56(e) of the Federal Rules of Civil Procedure.

But it must be remembered that the appellee in this case is a corporation, which is immune from mortality, and that the death of its officers or agents does not affect its existence, and it must further be remembered that, as convincingly appears from Appellants' Brief on Appeal herein, the appellee acquired vast benefits from the performance by the appellants of their part of the joint venture agreement for which no adequate compensation or remuneration has been made to appellants, and it is continuing to reap such benefits, as demonstrated by its retention of its interests, through its subsidiary corporations.

For all of these reasons the appellants reiterate that the action of the trial court in granting summary judgment was reversible error and the judgment should be set aside and the case remanded for trial.

Respectfully submitted,

PHIPPS & PHIPPS,  
By HARVE H. PHIPPS, SR.

*Attorneys for Appellants.*











